



Federal Accounting Standards Advisory Board

April 21, 2005

Memorandum

To: Members of the Board

From: Julia E. Ranagan, Assistant Director

Through: Wendy M. Comes, Executive Director

Subj: Research into the Application of the Liability Definition¹ – Tab C

At the March 3, 2005 meeting, staff presented a discussion of alternative obligating events for the Supplemental Security Income (SSI) program. Staff recommended that the determination of eligibility be selected as the obligating event for SSI. Board members found the analysis to be very helpful but reserved a decision on the obligating event for SSI until a more finalized definition of liabilities is agreed upon in the Concepts project. The Board requested that staff pick one or two other programs to review and come back to the Board at a subsequent meeting to discuss alternative obligating events and display options for the selected program(s).

This tab presents fact sheets on two programs administered by the Farm Service Agency – the Milk Income Loss Contract (MILC) Program and the Feed Grains Direct and Counter-Cyclical Payment (DCP) Program – and a discussion of several alternative obligating events for each program. This paper focuses primarily on the selection of an obligating event; a discussion of recognition, measurement, and display has been deferred. It is staff's hope that conclusions reached with respect to the alternative obligating events for these programs could be uniformly applied to other farm support programs.

The staff objective for the May meeting is to obtain comments, suggestions, and continued direction for the project. Staff would specifically like to obtain the Board's response to the following question:

Do you agree with staff's recommendation of the obligating event for the two farm support programs presented being at the point of submission of the contract and documentation of supporting requirements?

Please contact me at 202-512-7377 or by e-mail at ranaganj@fasab.gov with questions or comments.

¹ The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

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Staff Objective for this Paper

To discuss alternative obligating events for the two selected federal programs in the context of FASAB objectives for federal financial reporting and current Board deliberations on the Elements and Social Insurance Liability projects. To obtain the Board's general feelings of whether an alternative obligating event earlier than due and payable would be appropriate for the selected programs.

Selected Programs

Note: The information and details contained in the program fact sheets starting on page 35 are critical to the understanding of these programs and staff's analysis.

Milk Income Loss Contract Program

Farm Service Agency's (FSA) Milk Income Loss Contract (MILC) Program financially compensates dairy producers when domestic milk prices fall below a specified level. The program is authorized by the Farm Security and Rural Investment Act of 2002 (Farm Act) and has no set funding level.

Eligible dairy producers are those who, beginning December 1, 2001, through September 30, 2005, (1) commercially produce and market cow milk in the United States; or (2) produce milk in the United States and commercially market the milk outside the United States. Payments are made monthly based on production. For more detailed information, see the FSA fact sheet at Appendix 1 and the MILC fact sheet at Appendix 3.

Feed Grains Direct and Counter-Cyclical Payment Program

The Farm Act provides for direct and counter-cyclical payments, nonrecourse marketing assistance loans, and loan deficiency payments for the 2002-2007 crops to help ensure a strong and viable U.S. agriculture sector.

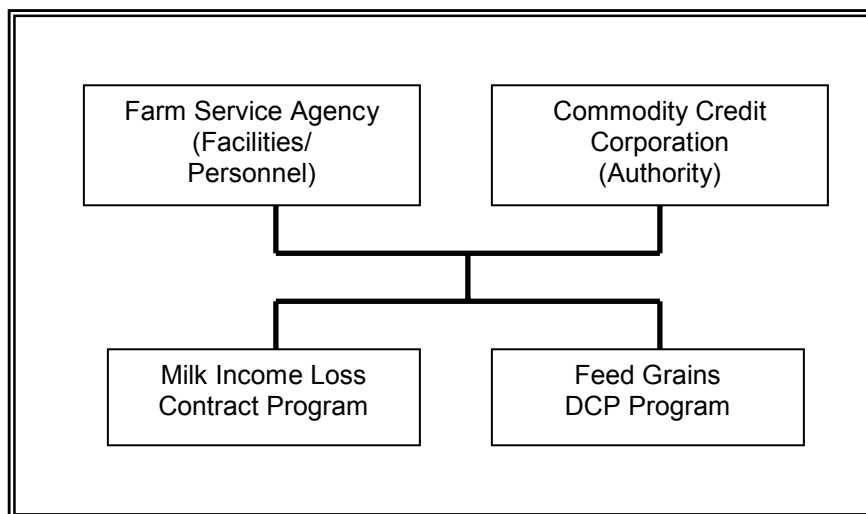
Direct and counter-cyclical payments reduce financial risks and help producers meet their cash flow needs. Marketing assistance loans provide producers interim financing at harvest time to meet cash flow needs without having to sell their commodities when market prices are typically at harvest-time lows. Allowing producers to store production at harvest facilitates more orderly marketing of commodities throughout the year. Loan deficiency payments are made to producers who are eligible to obtain a loan, but agree to forgo the loan. Due to time considerations, the discussion of an obligating event for the feed grain program is limited to direct and counter-cyclical payments.

FSA carries out the Farm Act for a variety of commodities, the largest of which is feed grains. Payments are made in two to three installments based on the base acres and payment yields established for the farm. For more detailed information, see the FSA fact sheet at Appendix 1 and the Feed Grains fact sheet at Appendix 4.

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Because the authority for both the MILC program and the Feed Grains Direct and Counter-Cyclical payment (DCP) program resides with the Commodity Credit Corporation (CCC) and FSA provides the facilities and operating personnel to carry out the programs of CCC, the chart below is presented to depict the relationship between FSA, CCC, and the two selected programs. See Appendix 2 for more information on CCC and Appendix 5 for a comparison of selected characteristics of the MILC and Feed Grains DCP programs.



Relationship between FSA, CCC, and selected programs

FASAB Objectives for Federal Financial Reporting

Identifying an alternative obligating event earlier than due and payable for the selected programs may require the Board to consider what the overall objective is for providing this information, and what the objective is for the balance sheet and statement of net cost. The following objectives from SFFAC 1 seem especially relevant:¹

Objective #2 – Operating Performance – Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine:

- 2A. the costs of providing specific programs and activities and the composition of, and changes in, these costs;
- 2B. the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and
- 2C. the efficiency and effectiveness of the government's management of its assets and liabilities.

¹ FASAB: Original Pronouncements, Version 4 (06/2004), p. 6

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Objective #3 – Stewardship – Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine whether:

3A. the government's financial position improved or deteriorated over the period;

3B. future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due; and,

3C. government operations have contributed to the nation's current and future well-being.

Characteristics of a Liability

At the December 2004 meeting, the Board continued deliberations begun at previous meetings under the Elements project as to whether the essential characteristics of liabilities identified by FASB in its Concepts Statements 6 for private-sector entities are also essential characteristics of federal liabilities, and/or whether federal liabilities have other essential characteristics. The characteristics of FASB are (par. 36):

- (a) It embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand;
- (b) The duty or responsibility obligates a particular entity leaving it little or no discretion to avoid the future sacrifice; and
- (c) The transaction or other event obligating the entity has already happened.

At the March 2005 meeting, staff on the Elements project presented a draft liability definition that was based on the same "essential characteristics of a liability" as FASB's above but with specific application to the federal environment. Paragraph L7 of staff's draft paper for the March meeting stated "A federal entity has a liability when both of these characteristics exist:

- (a) The federal entity has a present obligation² to provide cash, goods, or services to another entity in the future.
- (b) Under existing conditions, the federal entity is required to settle the obligation at a specified or determinable date, when a specified event occurs, or on demand."

The Board will continue discussions of the new draft liability definition at a future meeting.

² The term *obligation* is used in this Statement with its general meaning of a duty or responsibility to act in a certain way. It is not intended to mean that an obligation of budgetary resources is required for a liability to exist in accounting or financial reporting.

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Discussion of the Characteristics of a Present Obligation

The first characteristic of a liability in the previous section relates to a present duty or responsibility (present obligation). As discussed in prior Board meetings, for exchange transactions, the present obligation is generally created at the point that the exchange occurs. However, for non-exchange and exchange-like transactions, where there is no defined point of exchange, a different approach must be taken to determine when the obligating event occurs. Staff on the Elements project will be taking a conceptual look at this as the liability definition is developed.

In the meantime, in its memo for the May board meeting, staff on the Social Insurance Liability Project discusses the essential characteristics of a present obligation for social security in the following manner:

“For Social Security, current law provides the conditions that, once met, qualify the participants to receive a specific benefit for a specific period of time. Such benefits begin within a discernable range of dates and end upon occurrence of a specified event. The specificity of the law with respect to qualification for benefits, timing and amount of benefit payments, and provision of recourse if benefits are unlawfully withheld influenced the determination of what past transaction (obligating event) creates a present obligation to make a future sacrifice consistent with the liability definition. The Board evaluated the steps leading to being eligible to receive benefit payments and determined that the past event that creates a present obligation for Social Security is work in covered employment combined with attainment of fully insured status upon 40 quarters of work and that the expense associated with future benefit payments also should be recognized upon occurrence of that event.

In addition, participants in Social Security perform work in covered employment which causes them to be eligible for future benefits when other conditions are met. The wages earned in covered employment and other factors (for example, indexing of wages for inflation) determine their future benefits. The relationship of work in covered employment to future benefits means that a portion of future benefits are attributable to events occurring before or during the period being reported on. This connection between future benefit payments and past events - perhaps coupled with meeting conditions for eligibility - suggests that a present obligation to make a future sacrifice arises from these past events. The Board evaluated the link between events leading to benefit payments and determined that a present obligation is caused by work in covered employment combined with attainment of fully insured status upon 40 quarters of work and that the expense associated with future benefit payments also should be recognized upon occurrence of that event.

These characteristics are together sufficient to determine that a present obligation exists. However, the Board is aware that there are varying perspectives regarding the program. Some may find other characteristics relevant. Alternative characteristics are the specificity of benefits and benefit formulas; the “permanence of funding;” and direct communication of benefit information. With respect to the permanence of funding, the Board notes that, while the existence of funding is not required for a liability to exist, some believe the permanence of funding gives weight to the notion that an obligation exists, especially when the participants are providing that funding. Current law not only provides all the means to determine the entitlement, amount and timing of benefits but also provides a perpetual (but not unlimited) source of funding through the combination of the trust fund and payroll taxes.”

Staff will use the concepts of eligibility, performance, and conditions in a similar manner to discuss the present obligation of the selected programs below.

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Milk Income Loss Contract Program

Life Cycle Events: MILC

Through the life cycle of the MILC program, the following events occur at least once:

1. Authorization (M)³ - The program is authorized until 2005 by the Farm Security and Rural Investment Act of 2002.⁴ At the time of authorization, no amounts had been appropriated and no producers had signed up for the program by completing a MILC.
2. Appropriation (M) – The Commodity Credit Corporation (and the majority of the programs under its authority, including MILC) receives an annual indefinite appropriation through the normal appropriation process explained in OMB Circular A-11 – *Preparation, Submission, and Execution of the Budget*.⁵ The fiscal year 2005 appropriation included the following appropriation language for CCC:

COMMODITY CREDIT CORPORATION FUND
REIMBURSEMENT FOR NET REALIZED LOSSES

For the current fiscal year, such sums as may be necessary
to reimburse the Commodity Credit Corporation for net realized
losses sustained, but not previously reimbursed, pursuant to section
2 of the Act of August 17, 1961 (15 U.S.C. 713a–11)⁶

At the time of the initial appropriation, no producers had signed up for the program by completing a MILC.

3. Production and commercial marketing of milk (P) – Eligible producers are those that are involved in the production and commercial marketing of milk from December 1, 2001 through September 30, 2005. Producers can receive a lump sum payment for milk produced and commercially marketed during the eligibility period once the producer submits the MILC and documentation of supporting requirements. These payments are referred to as transition period payments and are calculated by multiplying the quantity of milk produced and commercially marketed (up to 2.4 million pounds per year) times 45 percent of the difference between \$16.94 and the Boston Class I price for each month in the transition period. The transition period is from December 1, 2001 through the date the producer submits a MILC. After the MILC is submitted and approved, each eligible producer receives a monthly contract payment for the quantity of milk produced and commercially marketed each month that the Boston Class I milk price falls below \$16.94 per cwt.

³ (M) = MILC Program-Level, (P) = Producer-Level

⁴ The Budget of the United States Government, Fiscal Year 2006 proposes extending the authorization through December 31, 2007, the duration of the 2002 Farm Act.

⁵ <http://www.whitehouse.gov/omb/circulars/a11/04toc.html>

⁶ Public Law 108-447, p. 118

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4. Submission of MILC and documentation of supporting requirements (P) – To be eligible to receive MILC payments, a dairy operation must:⁷
- (a) Have produced milk in the United States and commercially marketed the milk produced anytime during the period of December 1, 2001, through September 30, 2005;
 - (b) Enter into a MILC during the contract application period;
 - (c) Agree to all terms and conditions in the MILC and comply with instructions issued by the CCC;
 - (d) Provide proof of monthly milk production commercially marketed by all persons in the dairy operation during the contract period to determine the total pounds of milk that will be converted to hundredweight (cwt.) used for payment;
 - (e) Submit evidence of production in a timely manner; and,
 - (f) Be actively engaged in the business of producing and marketing agricultural products at the time of signing the MILC.

At the time of submission of the MILC and documentation of supporting requirements, the producer has formally accepted the terms of the program but the MILC has neither been approved nor disapproved by an authorized representative of the CCC.

5. Acceptance of the MILC (P) – When the authorized representative from CCC approves and signs the MILC, he or she is accepting the terms of the contract whereby “CCC agrees, subject to the availability of funds, to pay the participant, to the extent required by the applicable CCC regulations, the agreed upon monthly payment, based upon the shares to which the parties have agreed as set forth on Form CCC-580 for a period of years not in excess of the contract period.”⁸ At the time of acceptance of the MILC by the CCC, there is a contract between the CCC and the producer that establishes the basis for payment in the future should the Boston Class I milk price fall below \$16.94 per hundredweight (cwt). In addition, the producer is eligible for a lump sum transition period payment whereby CCC will pay the producer for milk marketed from December 1, 2001, through the last day of the month preceding the month the operation’s MILC contract is submitted (up to the cap of 2.4 million pounds per year).
6. Producer selects payment start month (P) - Beginning with the 2003 fiscal year, dairy producers who do not want their payments to begin with the first month of the fiscal year must select the month they want to start receiving payments. Producers will be eligible for the payment rate in the month they select, plus payment rates for the consecutive months that follow. Producers in a dairy operation who choose not to select a starting month at the time they sign up must inform their local FSA office that they will make a start month selection at a later time. Producers who do not select a start month or make this notification will receive their payments beginning with the first month of the fiscal year.
7. Boston Class I milk price falls below \$16.94 per cwt/Payment (P) – MILC contract payments are made on a monthly basis when the Boston Class I milk price falls below \$16.94 per hundredweight (cwt). Producers are responsible for providing proof of the milk production commercially marketed for that month.

⁷ Federal Register Vol. 67, No. 202, §1430.203

⁸ Appendix to Form CCC-580, Milk Income Loss Contract, Section 19B

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Alternative Obligating Events: MILC

Based on the life cycle events discussed above, possible alternative obligating events for the MILC program are:

1. Authorization – The MILC program is authorized until 2005 by the Farm Security and Rural Investment Act of 2002.
2. Appropriation – The Commodity Credit Corporation (and the majority of the programs under its authority, including MILC) receives an annual indefinite appropriation.
3. Birth/Immigration – An individual is born that could potentially one day seek benefits under the MILC program.
4. Production and commercial marketing of milk – Producers are involved in the production and commercial marketing of milk from December 1, 2001 through September 30, 2005.
5. Submission of the MILC and documentation of supporting requirements – To apply for the MILC program, dairy operation producers must submit form CCC-580, "Milk Income Loss Contract," to the FSA county office where the dairy operation is located. At this time, the producer must have satisfied a myriad of requirements in addition to submission of the MILC. At this point, the producer has formally accepted the terms of the program but the MILC has neither been approved nor disapproved by an authorized representative of the CCC.
6. Acceptance of the MILC – An authorized representative of CCC reviews the documentation of supporting requirements, marks the MILC as either approved or disapproved, and then signs it.
7. Producer selects a payment start month – A producer selects a payment start month; he or she cannot receive a monthly contract payment until he or she has selected a payment start month.
8. Boston Class I milk price falls below \$16.94 per cwt – MILC contract payments are made on a monthly basis when the Boston Class I milk price falls below \$16.94 per cwt. Producers are responsible for providing proof of the milk production commercially marketed for that month before payment will be made.
9. Payment/Due and Payable – Support payments are required to be recognized as liabilities and expenses at the point they become "due and payable." Monthly contract payments are recognized as liabilities at the point the Boston Class I milk price falls below \$16.94 per cwt and acceptable proof of the milk production commercially marketed for that month is received. Transition payments are recognized as liabilities shortly after the MILC is accepted by the authorized representative of CCC.

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Discussion of Alternative Obligating Events: MILC

The alternative obligating events identified above are discussed below with respect to the three characteristics required in order to be considered a liability and the two characteristics of a present obligation developed under social insurance. It is important to note that this discussion is based on "current law." It is recognized that Congress has the ability to change current law at its discretion but accountants usually do not estimate or forecast for possible changes in law unless such changes are imminent.

1. Authorization

Discussion

The MILC program is authorized until 2005 by the Farm Security and Rural Investment Act of 2002. At the point of authorization, some could argue that there is an established intent to create an obligation on behalf of the government. However, the ability of accountants to objectively identify and measure intent is limited.

Since no producers had applied for benefits, no event has occurred that would leave the government with little or no discretion to avoid payment of benefits to one or more other entities. Therefore, the point of authorization would appear to fail all three characteristics of a liability.

Summary of Characteristics

At the point of authorization:

- a. There is no present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time the MILC program was authorized in 2002, no producers had met the conditions of the program or were performing under the terms of the program.
 - i. Conditions – Conditions specified by current law to qualify the producers to receive a specific benefit for a specific period of time have not been met. At the point of authorization, no producers had yet met the conditions of the program.
 - ii. Performance – There were no current producers that were performing under the terms of the program at the time of authorization.
- b. Since there is no present duty or responsibility, the government is not left with little or no discretion to avoid the future sacrifice; and
- c. Since there is no present duty or responsibility, the transaction or event has not already happened.

2. Appropriation

Discussion

Initial Appropriation – As discussed above, at the point of the initial appropriation, no producers had met the conditions of the program or were performing under the terms of the program. Therefore, since there were no producers yet enrolled in the program and no reasonable reliance placed upon the continued payment of MILC benefits, it would appear that there were no entities to which a present obligation had been created that would leave the government little or no discretion to avoid the future sacrifice.

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Subsequent Appropriations - As the MILC program continues, producers continue to receive benefits each year as long as they continue to meet the conditions of the program and the Boston Class I milk price falls below \$16.94 per cwt. A producer does not need to reapply each year and can reasonably expect to continue receiving payments as long as they meet the program conditions established under current law. Furthermore, there is a proposal in the 2006 budget submission to extend the MILC program until 2007, in line with the other programs authorized by the 2002 Farm Act. Some could argue that the continuation of the MILC program (both from the collective viewpoint and an individual's viewpoint) is likely and could set up a scenario where participants become highly reliant on the program, leaving the government little or no discretion to avoid the future sacrifice. However, others could argue that the mere event of appropriation would not create a present obligation for a program that enrolls new participants each year (e.g., student loans and the feed grains direct and counter-cyclical payment program) and for which payment is contingent on occurrence of a specific event (e.g., milk prices falling below an established floor).

Summary of Characteristics

At the point of appropriation:

- a. There is no present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand.
 - i. Conditions – Conditions specified by current law to qualify the producers to receive a specific benefit for a specific period of time have not been met. At the point of appropriation, there are no producers that have met the conditions of the program.
 - ii. Performance – There are no producers that are performing under the terms of the program. The point of appropriation is not sufficient, in and of itself, to create an obligating event. There must be some individuals that are performing under the terms of the program, taking the first step towards accepting the terms of the program.
- b. Since there is no present duty or responsibility, the government is not left with little or no discretion to avoid the future sacrifice; and
- c. Since there is no present duty or responsibility, the transaction or event has not already happened.

3. *Birth/Immigration*

Discussion

Some could argue that merely being born or immigrating into the United States entitles an individual to certain benefits that have historically been provided over many decades. However, the MILC program is only authorized until 2005 and the continuation of the program is not imminent -- no one born within the last three years (when the program started) would reasonably be relying on the program today or even in 2007 (the proposed new end date for the program). In addition, to be eligible to receive payment, producers must be engaged in the production and commercial marketing of milk from December 1, 2001 through September 30, 2005. Therefore, under law that is currently authorized through 2005, at the point of birth or immigration, no individuals have been determined to meet the conditions of the program nor are they performing under the terms of the

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program. As such, there would be no one relying on the program that would leave the government little or no discretion to avoid the future sacrifice.

Summary of Characteristics

At the point of birth/immigration:

- a. There is no present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time that individuals are born or immigrate to the United States, none of them have met the conditions of the program nor are they performing under the terms of the program.
 - i. Conditions – Conditions specified by current law to qualify the participants to receive a specific benefit for a specific period of time have not been met. At the point of birth/immigration, no individuals have met the conditions of the program.
 - ii. Performance – There are no current participants that are performing under the terms of the program at the time of birth or immigration.
- b. Since there is no present duty or responsibility, the government is not left with little or no discretion to avoid the future sacrifice; and
- c. Since there is no present duty or responsibility, the transaction or event has not already happened.

4. Production and commercial marketing of milk

Discussion

A producer that is eligible to receive benefits under the MILC program could be any individual or entity that directly or indirectly shared in the risk of producing milk and made contributions (including land, labor, management, equipment, or capital) to the dairy farming operation of the individual or entity that are at least commensurate with the share of the individual or the entity of the proceeds of the operation from December 1, 2001 through September 30, 2005. A producer can sign up for the MILC program any time from August 13, 2002 until September 30, 2005. At the present time, there could still be producers that have not signed up for the MILC program and will be eligible to receive large lump sum transition payments when they do eventually sign up sometime between now and September 30, 2005. In fact, many large producers had delayed signing up because of a lawsuit that was filed by several large producers who had interpreted the 2002 Farm Act to have no cap on transition period payments. The 2002 Farm Act clearly states that there is a 2.4 million pound annual cap on monthly contract payments but does not specifically state that there is the same cap on transition period payments. Thus, several large producers had filed a lawsuit to dispute USDA's interpretation of the 2002 Farm Act whereby USDA applied the cap to the transition period payments as well. The producers contended that, under a strict interpretation of the 2002 Farm Act, they should be allowed to sign up for the MILC program on September 30, 2005 and receive a lump sum transition period payment for all milk commercially marketed during the period of December 1, 2001 through September 30, 2005. However, through a 2003 ruling by the United States District Court for the Northern District of Ohio and a 2004 appeal ruling by the United States Court of Appeals for the Sixth Circuit, both courts upheld that USDA's interpretation of the ambiguous act was reasonable.

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In its discussion of the SSI program at the March 2005 Board meeting, several Board members indicated that they might look to the point of the disabling event as being the true obligating event since that is the trigger for the individual becoming eligible for the program benefits. Staff responded that there was some discussion in the social insurance session of whether the two proposed characteristics of a present obligation would apply to a pension program or a social program, but under either characteristic, the recipient/participant/individual is doing something towards accepting the terms of the program. The requirement to be taking some step towards accepting the terms of the program would rule out earlier obligating events where the individual had not yet taken a step towards doing something, towards accepting the terms of the program. At the point of production and commercial marketing of milk, the producers have not yet accepted the terms of the program.

Summary of Characteristics

At the point of production and commercial marketing of milk:

- a. There is no present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time that individuals produced and commercially marketed milk but prior to submission of the MILC and documentation of supporting requirements, they have not yet met the conditions of the program nor are they performing under the terms of the program.
 - i. Conditions – Conditions specified by current law to qualify the participants to receive a specific benefit for a specific period of time have not been met. At the point of production and commercial marketing of milk, no individuals have met the conditions of the program.
 - ii. Performance – There are no current participants that are performing under the terms of the program before they have at least completed the MILC and submitted documentation of the supporting requirements for the program.
- b. Since there is no present duty or responsibility, the government is not left with little or no discretion to avoid the future sacrifice; and
- c. Since there is no present duty or responsibility, the transaction or event has not already happened.

5. Submission of the MILC and documentation of supporting requirements

Discussion

To apply for the MILC program, dairy operation producers must submit form CCC-580, "Milk Income Loss Contract," to the FSA county office where the dairy operation is located. To be eligible to receive MILC payments, a dairy operation must have:

- (a) Produced milk in the United States and commercially marketed the milk produced anytime during the period of December 1, 2001, through September 30, 2005;
- (b) Entered into a MILC during the contract application period;
- (c) Agreed to all terms and conditions in the MILC and complied with instructions issued by the CCC;
- (d) Provided proof of monthly milk production commercially marketed by all persons in the dairy operation during the contract period to determine the total

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- pounds of milk that will be converted to hundredweight (cwt.) used for payment;
- (e) Submitted evidence of production in a timely manner; and,
 - (f) Been actively engaged in the business of producing and marketing agricultural products at the time of signing the MILC.

Under the current liability standards, liabilities are accrued for the MILC program when “due and payable.” Thus, the obligating event occurs when absolutely all conditions necessary for payment have been met. A potential obligating event for the MILC program other than “due and payable” would rely on the fact that remaining unmet conditions are (1) beyond the control of the government under current law and (2) the likelihood that the conditions will remain unmet is remote to varying degrees within the population.

Some could argue that the obligating event occurs when the producer accepts the terms/conditions of the government’s offer. At the time the producer submits the MILC and supporting documentation, the producer is accepting the conditions of the program. FAS 88: Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, par. 44, states:

“Statement 74 addressed accounting for special termination benefits whether or not provided through a defined benefit pension plan, that are offered for a short period of time in exchange for employees' voluntary termination of service. The primary conclusion of the Board in Statement 74 was that the cost of special termination benefits should be recognized as a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. That conclusion is incorporated in this Statement. The cost of other termination benefits provided by the existing terms of a plan that are payable only in the event of employees' involuntary termination of service due to a plant closing or a similar event should be recognized when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. The majority of respondents addressing this issue agreed with those conclusions.”

As noted in the paragraph above, in the case of voluntary termination benefits, FASB has determined that a liability should be recognized when the employees accept the offer and the amount can be reasonably estimated. If one were to apply this concept to MILC benefits, one could argue that a liability could be recognized for all transition period payments (known quantity and price) at the time that the producer submits the MILC and supporting documentation. However, the future monthly contract payments for milk production commercially marketed in months when the Boston Class I milk price falls below \$16.94 per cwt would be much more difficult to estimate since the estimate would be based upon a contingent event. See staff’s discussion of recognition for contingent events below.

Since SFFAS 3 is related to accounting for inventory and related property, it does not address price support programs where the commodities are not purchased. However, SFFAS 3 does require that the estimated amount of contingent losses for commodity purchase agreements⁹ be recognized as a contingent liability if the loss is more likely than not and measurable.¹⁰ Excerpts from SFFAS 5 regarding recognition for contingencies are included on the next three pages.

⁹ Commodity purchase agreements are agreements to purchase commodities at a given price at the option of the seller.

¹⁰ SFFAS 3 Basis for Conclusion par. 162 noted that “One respondent argued that purchase agreements constitute a contingent liability. The proposed standard would require recognizing a liability and a loss **if the contract price**

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Excerpts from SFFAS 5, *Accounting for Liabilities of the Federal Government*

SFFAS 5, *Accounting for Liabilities of the Federal Government*, contains the following discussion on the objectives of federal financial reporting that are extremely relevant to this discussion:¹¹

The objectives of federal financial reporting were designed to guide the Board in developing accounting standards to enhance the financial information reported by the federal government. The four objectives are discussed under the headings (1) budgetary integrity, (2) operating performance, (3) stewardship, and (4) systems and control. These objectives were used as a basis to develop the Liability Statement. The Board believes that the operating performance objective has special relevance to decisions about recognition and measurement of liabilities in general purpose federal financial reports. That objective reads as follows:¹²

Federal financial reporting should assist report users in evaluating the service efforts, cost, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.

At the same time, the Board recognizes that the third objective, dealing with stewardship, is equally important.

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future.

Federal financial reporting should provide information that helps the reader to determine:

- whether the government's financial position improved or deteriorated over the period;
- whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due; and
- whether government operations have contributed to the nation's current and future well-being.

Examples of information relevant to this objective include:

- the amount of assets, liabilities, and net assets (or net position);
- an analysis of government debt, its growth, and debt service requirements;
- changes in the amount and service potential of capital assets; and
- the amount of contingent liabilities and unrecognized obligations¹³ (such as the probable cost of deposit insurance).

Accordingly, information about projected future responsibilities and resources is as important as information about assets, liabilities, revenues, and expenses. [emphasis added]

exceeded the expected net realizable value of the commodities. It is clear that at any given time the market price may be lower than the contract price but that due to cycles in the harvest and post-harvest market this may not be an indication that the contract will be executed and a loss realized. The Board revised the standard to provide for loss recognition in connection with purchase agreements if the loss is both probable and measurable."

¹¹ FASAB: Original Pronouncements, Version 4 (06/2004), pp. 418-419

¹² Statement of Federal Financial Accounting Concepts Number 1, Objectives of Federal Financial Reporting (Sept. 2, 1993).

¹³ The term "obligation" is used in its everyday or generic sense, not as it is used in federal budgetary accounting.

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Excerpts from SFFAS 5 contd.

SFFAS 5 contains the following requirements for contingencies:¹⁴

Contingencies—A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. Contingent future outflows or other sacrifices of resources as a result of past transactions or events may be recognized, may be disclosed,¹⁵ or may not be reported at all, depending on the circumstances.¹⁶ Contingencies should be recognized as a liability when a past transaction or event has occurred, a future outflow or other sacrifice of resources is probable, and the related future outflow or sacrifice of resources is measurable. A contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is a reasonable possibility that a loss or an additional loss may have been incurred. Disclosure should include the nature of the contingency and an estimate of the possible liability, an estimate of the range of the possible liability, or a statement that such an estimate cannot be made.

In addition, SFFAS 5 contains the following requirements for insurance and guarantee programs:¹⁷

Insurance and guarantee programs—All federal insurance and guarantee programs⁷ (except social insurance and loan guarantee programs⁸) should recognize a liability for unpaid claims incurred resulting from insured events that have already occurred. Insurance and guarantee programs recognize as an expense all claims incurred during the period, including, when appropriate, those not yet reported. The change in a contingent liability during the reporting period should also be recognized as a component of expense. Life insurance programs should recognize a liability for future policy benefits in addition to the liability for unpaid claims incurred. All federal insurance and guarantee programs (except life insurance and loan guarantee programs) should also report as required supplementary stewardship information (RSSI) the expected losses that are based on risk inherent in the insurance and guarantee coverage in force.

SFFAS 5 contains the following classifications of probability:¹⁸

This Statement does not deal with gain contingencies or measurement of contingencies that involve impairment of nonfinancial assets. When a loss contingency (i.e., contingent liability) exists, the likelihood that the future event or events will confirm the loss or the incurrence of a liability can range from probable to remote. The probability classifications are as follows:

- Probable: The future confirming event or events are more likely than not to occur.
- Reasonably possible: The chance of the future confirming event or events occurring is more than remote but less than probable.
- Remote: The chance of the future event or events occurring is slight.

¹⁴ FASAB: Original Pronouncements, Version 4 (06/2004), p. 412

¹⁵ "Disclosure" in this document refers to information in notes regarded as an integral part of the basic financial statements.

¹⁶ In the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions, a liability would then be recognized at the point the unpaid amount is due. Therefore, government-acknowledged events do not meet the criteria necessary to be recognized as a contingent liability.

¹⁷ FASAB: Original Pronouncements, Version 4 (06/2004), p. 413

¹⁸ FASAB: Original Pronouncements, Version 4 (06/2004), p. 427

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Excerpts from SFFAS 5 contd.

SFFAS 5 contains the following criteria for recognition of a contingent liability:¹⁹

A contingent liability should be recognized when all of these three conditions are met:²⁰

- A past event or exchange transaction has occurred (e.g., a federal entity has breached a contract with a nonfederal entity).²¹
- A future outflow or other sacrifice of resources is probable (e.g., the nonfederal entity has filed a legal claim against a federal entity for breach of contract and the federal entity's management believes the claim is ... likely ... [Note that SFFAS 12 changed the definition of "probable" in cases involving litigation from "more likely than not" to "likely." See SFFAS 12 for more explanation. Also note that this parenthetical example would no longer be typical of the "more likely than not" application.] to be settled in favor of the claimant).
- The future outflow or sacrifice of resources is measurable (e.g., the federal entity's management determines an estimated settlement amount).

The estimated liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, that amount is recognized. If no amount within the range is a better estimate than any other amount, the minimum amount in the range is recognized and the range and a description of the nature of the contingency should be disclosed.

SFFAS 5 contains the following criteria for disclosure of a contingent liability:²²

A contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred. "Disclosure" in this context refers to reporting information in notes regarded as an integral part of the basic financial statements.

Disclosure should include the nature of the contingency and an estimate of the possible liability, an estimate of the range of the possible liability, or a statement that such an estimate cannot be made.

In some cases, contingencies may be identified but the degree of uncertainty is so great that no reporting (i.e., recognition or disclosure) is necessary in the general purpose federal financial reports. Specifically, contingencies classified as remote need not be reported in general purpose federal financial reports, though law may require such disclosures in special purpose reports. If information about remote contingencies or related to remote contingencies is included in general purpose federal financial reports (e.g., the total face amount of insurance and guarantees in force), it should be labeled in such a way to avoid the misleading inference that there is more than a remote chance of a loss of that amount.

¹⁹ FASAB: Original Pronouncements, Version 4 (06/2004), p. 428

²⁰ The unit of analysis for estimating liabilities can vary according to the reporting entity and the nature of the transaction or event. The liability recognized may be the estimation of an individual transaction or event; or a group of transactions and events. For example, SFFAS Number 2, "applies to direct loans and loan guarantees on a group basis, such as a cohort or a risk category of loans and loan guarantees. Present value accounting does not apply to direct loans or loan guarantees on an individual basis, except for a direct loan or loan guarantee that constitutes a cohort or a risk category." Statement of Federal Financial Accounting Standards Number 2, Accounting for Direct Loans and Loan Guarantees. par. 21. See the standard on Insurance and Guarantees in this document for a description of incurred but not reported (IBNR) claims.

²¹ In the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions, a liability would then be recognized at the point the unpaid amount is due. Therefore, government-acknowledged events do not meet the criteria necessary to be recognized as a contingent liability.

²² FASAB: Original Pronouncements, Version 4 (06/2004), p. 429

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Staff believes that the recognition criteria for a contingent liability from SFFAS 5 (see excerpt on previous page) is sound. The following points address each of the criteria for recognizing a contingent liability with respect to the MILC program:

1. A past event or exchange transaction has occurred – Staff is proposing that the point of submission of the MILC and documentation of supporting evidence is a valid obligating event for the MILC program. Therefore, staff would argue that the first criteria for recognizing a contingent liability is met at that point – the past event (obligating event) has occurred.
2. A future outflow or other sacrifice of resources is probable – At the point of submission of the MILC and documentation of supporting evidence, there are months during the transition period (December 1, 2001 through the point of application) where the Boston Class I milk price has fallen below \$16.94 per cwt. Therefore, as long as the producer's documentation is in order, a transition period payment will be made. As far as monthly contract payments are concerned, FSA management would be the most appropriate individuals to determine whether, for any given year, a drop in the milk price is probable. This could probably be predicted through current trends in the milk marketing industry and would most likely differ from year to year. Staff believes that it would not be appropriate for the Board to decide what is probable. The established criteria would be sufficient to guide FSA and its auditors in determining what is probable or not. The draft liability characteristics on page 3 purposely exclude an explicit discussion of probability in order to cast a wide net for designation as a liability. It is up to the Board to decide if they prefer the wide net or a narrower one, and tailor the liability definition accordingly.
3. The future outflow or sacrifice of resources is measurable - At the point of submission of the MILC and documentation of supporting evidence, there are months where the Boston Class I milk price has fallen below \$16.94 per cwt. The prices from past months are known at the point of submission of the MILC and the quantities are contained in the producer's documentation of supporting evidence. Therefore, as long as the producer's documentation is in order, a transition period payment can be calculated at the point of submission of the MILC and the documentation of supporting evidence. As far as monthly contract payments are concerned, FSA management would be the most appropriate individuals to determine whether, for any given year, a drop in the milk price is measurable. This could probably be predicted through current trends in the milk marketing industry and would most likely differ from year to year. Staff believes that it would not be appropriate for the Board to decide what is measurable. The established criteria would be sufficient to guide FSA and its auditors in determining what is measurable or not.

For the reasons cited in the above discussion and current work in other projects, staff feels that the selection of "submission of the MILC and documentation of the supporting evidence" would be valid and would not necessitate differentiating between transition period payments and monthly contract payments. The criteria for recognition and measurement would be established in such a way that the most appropriate individuals

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(agency management) could determine which of their programs meet the recognition and measurement criteria.

Finally, one additional consideration for this potential obligating event is that, at the point that the MILC is submitted, it has not been formally ratified or approved by an authorized representative from CCC. However, that technicality would not necessarily prevent CCC from being legally obligated to pay the benefits if the producers met all conditions of the program and performed under the terms of the contract (see discussion of the potential obligating event of "Acceptance of the MILC" below).

Summary of Characteristics

At the point of submission of the MILC and documentation of supporting requirements:

- a. There is a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time that the producers submit the MILC and documentation of supporting requirements, they are accepting the terms of the program.
 - i. Conditions – Conditions specified by current law to qualify the participants to receive a specific benefit for a specific period of time have been met. At the point of submission of the MILC and supporting requirements, the producers have met the conditions established by the government for the MILC program. All that remains is for CCC's authorized representative to review the documentation of supporting requirements, mark the MILC as either approved or disapproved, and then sign it.
 - ii. Performance – As the producers continue to produce and market milk and meet the Highly Erodible Land Conservation and Wetland Conservation provisions, they are performing under the terms of the program.
- b. Since there are producers that have met the conditions of the program, accepted the terms of the program, and continue to perform under the conditions of the program, the government is left with little or no discretion to avoid the future sacrifice; and
- c. The transaction or event has already happened that leaves the government little or no discretion to avoid the future sacrifice of resources to these producers that have applied for benefits.

6. Acceptance of the MILC

Discussion

At the point of acceptance of the MILC, an authorized representative of the CCC is making a uniform decision as to whether to accept or reject a producer into the MILC program based on the conditions of the program. This action in and of itself is not considered to be the obligating event; if one accepts staff's discussion in the previous point of submission of the MILC and documentation of supporting requirements, the obligating event is considered to have already occurred.

In its discussion of the SSI program at the March 2005 Board meeting, several Board members were uncomfortable with inserting the government determination or approval as a required step in the process. It was felt that, if the government laid out the conditions of the program, and there were individuals out there who met the conditions of the program,

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the government could have a liability, exclusive of the fact of whether the government had verified that the individuals had, in fact, met the conditions of the program.

Summary of Characteristics

At the point of acceptance of the MILC:

- a. There is a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time that the MILC is accepted by an authorized representative of the CCC, the producer is accepted into the MILC program, creating an expectation on the part of the producer that support payments will continue as long as the producer continues to meet the conditions of the program and performs under the terms of the program, thus leaving the government little or no discretion to avoid the future sacrifice.
 - i. Conditions – Conditions specified by current law to qualify the producers to receive a specific benefit for a specific period of time have been met. At the point of acceptance of the MILC, the producers have met the conditions to enable them to begin receiving payments under the MILC program.
 - ii. Performance – The producers begin performing under the terms of the program by successfully submitting a MILC and documentation of supporting requirements. They continue performing under the terms of the program by producing and commercially marketing milk and complying with the Highly Erodible Land Conservation and Wetland Conservation provisions.
- b. The present duty or responsibility obligates the government under current law, leaving it with little or no discretion to avoid the future sacrifice; and
- c. The transaction or event has already happened at the point of acceptance of the MILC.

7. Producer selects payment start month

Discussion

Beginning with the 2003 fiscal year, dairy producers who do not want their payments to begin with the first month of the fiscal year must select the month they want to start receiving payments. Producers will be eligible for the payment rate in the month they select, plus payment rates for the consecutive months that follow. Producers in a dairy operation who choose not to select a starting month at the time they sign up must inform their local FSA office that they will make a start month selection at a later time. Producers who do not select a start month or make this notification will receive their payments beginning with the first month of the fiscal year. Therefore, once a producer has signed up for the MILC program and received his lump sum transition period payment, he will also begin receiving a monthly contract payment when the Boston Class I milk price falls below \$16.94 per cwt. The monthly contract payments will begin with the month selected by the producer. If the producer does not select a start month, his payments will start with the month he submits his contract. If the producer notifies his local FSA office that he plans to select a start month at a later date but has not made a selection, he will not be paid for any months that pass until he designates a start month. Therefore, once the lump sum transition period payment is made, the government is not liable to the producer for any months before the payment start month, even if the Boston Class I milk price falls below \$16.94 per cwt.

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Summary of Characteristics

At the point of the selection of a payment start month:

- a. There is a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time that a payment start month is designated, the government will be required to make monthly contract payments from the designated month forward when the Boston Class I milk price falls below \$16.94 per cwt.
 - i. Conditions – Conditions specified by current law to qualify the participants to receive a specific benefit for a specific period of time have been met. At the point of selection of a payment start month, the producers have met the conditions of the program that enable them to begin receiving monthly contract payments.
 - ii. Performance – The participants are performing under the terms of the program. The producers must be producing and commercially marketing milk, submitting evidence of monthly marketing, and complying with the Highly Erodible Land Conservation and Wetland Conservation provisions to receive monthly contract payments.
- b. The present duty or responsibility obligates the government under current law, leaving it with little or no discretion to avoid the future sacrifice; and
- c. The transaction or event has already happened at the point of selection of a payment start month.

8. *Boston Class I milk price falls below \$16.94 per cwt*

Discussion

MILC contract payments are made on a monthly basis when the Boston Class I milk price falls below \$16.94 per hundredweight (cwt). Producers are responsible for providing proof of the milk production commercially marketed for that month. No payment will be made until the proof of the production commercially marketed for that month is confirmed through the marketing production statement that the producer obtains from the milk handler or dairy co-op and submits to the local FSA office.

Summary of Characteristics

At the point the Boston Class I milk price falls below \$16.94 per cwt:

- a. There is a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time that the Boston Class I milk price falls below \$16.94 per cwt, there is an expectation on the part of the producer that he will receive that payment as soon as he submits the necessary marketing production statement.
 - i. Conditions – Conditions specified by current law to qualify the participants to receive a specific benefit for a specific period of time have been met. At the point the Boston Class I milk price falls below \$16.94 per cwt, the producers have met the conditions of the program that enable them to receive a monthly contract payment for that month.
 - ii. Performance – The participants are performing under the terms of the program. The producers are producing and commercially marketing milk, and complying with the Highly Erodible Land Conservation and Wetland Conservation provisions.

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- b. The present duty or responsibility obligates the government under current law, leaving it with little or no discretion to avoid the future sacrifice; and
- c. The transaction or event has already happened at the point the Boston Class I milk price falls below \$16.94 per cwt.

9. *Payment/Due and Payable*

Discussion

Under the current liability standards set forth in SFFAS 5,²³ support payments are recognized as liabilities and expenses at the point they become “due and payable.” Monthly contract payments are recognized as liabilities at the point the Boston Class I milk price falls below \$16.94 per cwt and acceptable proof of the milk production commercially marketed for that month is received. They are not recognized as liabilities before the proof of the production commercially marketed for that month is confirmed through the marketing production statement that the producer obtains from the milk handler or dairy co-op and submits to the local FSA office. Transition payments are recognized as liabilities shortly after the MILC is accepted by the authorized representative of CCC, which includes acceptable documentation of milk marketed during the transition period. These due and payable benefits are legally enforceable under current law if unduly withheld.

Summary of Characteristics

At the point of due and payable:

- b. There is a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time that a payment is due and payable, an expectation on the part of the producer that he will receive that payment is backed by the legal enforceability of that expectation if the benefits are unduly withheld.
 - i. Conditions – Conditions specified by current law to qualify the participants to receive a specific benefit for a specific period of time have been met. At the point of due and payable, all conditions necessary for payment (terms of the program) have been met.
 - ii. Performance – The producers are performing under the terms of the program.
- c. The present duty or responsibility obligates the government under current law, leaving it with little or no discretion to avoid the future sacrifice; and
- d. The transaction or event has already happened at the point of due and payable.

* * * * *

²³ SFFAS 3, Accounting for Inventory and Related Property, par. 92 – 109, address Goods Held Under Price Support and Stabilization Programs. The MILC program does not purchase or hold goods; it provides a subsidy payment, and is therefore, not addressed under SFFAS 3.

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The four alternative obligating events to due and payable that seem plausible based on the discussion above are:

- Submission of the MILC and documentation of supporting requirements (for transition period and monthly contract payments)
- Acceptance of the MILC (for transition period and monthly contract payments)
- Selection of a payment start month (for monthly contract payments only)
- Boston Class I milk price falls below \$16.94 (for monthly contract payments only)

It is important to note that a Board member's preference for any of the four alternative obligating events above would have no bearing on the point at which benefits become legally enforceable. As with Social Insurance benefits, no payments are legally enforceable under current law until due and payable, regardless of when they are first recognized in financial reports. Agreeing on an earlier obligating event will not enable individuals to lay claim to benefits before all necessary conditions of the program have been met. However, accruing an expense and accumulating a liability on the Federal balance sheet, which is a primary means of communicating how the government's financial position has improved or deteriorated over the period, as producers accept the terms of the MILC program would focus management's attention on the economic costs of the promises being made.

Staff Recommendation: MILC

Staff believes that, if one accepts the argument of "little or no discretion to avoid the present obligation" as being the essence of a liability, or alternatively, "Under existing conditions, the federal entity is required to settle the obligation at a specified or determinable date, when a specified event occurs, or on demand," there is a strong argument for the point of submission of the MILC and documentation of supporting requirements as being a valid alternative obligating event to due and payable for the MILC program. Once a producer meets and accepts the terms of the program under current law, the producer can anticipate receiving benefits until such time that he no longer meets the conditions of the program and performs under the terms of the program.

Do you agree with staff's recommendation of the obligating event for MILC being at the point of submission of the MILC and documentation of supporting requirements?

got liability?

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Feed Grains Direct and Counter-Cyclical Payment Program

Note: Unlike the MILC program, payments under this program are NOT based on current production. The producers do not need to plant anything in the current year to receive payments; payments are calculated based on historical base acres and payment yields established for the farm.

Life Cycle Events: Feed Grains DCP

Through the life cycle of the Feed Grains Direct and Counter-Cyclical Payment (DCP) program, the following events occur at least once:

1. Authorization (F)²⁴ - The program is authorized until 2007 by the Farm Security and Rural Investment Act of 2002. At the time of authorization, no amounts have been appropriated and no producers have signed up for the program by completing a DCP contract.
2. Appropriation (F) – The Commodity Credit Corporation (and the majority of the programs under its authority, including Feed Grains) receives an annual indefinite appropriation through the normal appropriation process explained in OMB Circular A-11 – *Preparation, Submission, and Execution of the Budget*.²⁵ The fiscal year 2005 appropriation included the following appropriation language for CCC:

COMMODITY CREDIT CORPORATION FUND
REIMBURSEMENT FOR NET REALIZED LOSSES

For the current fiscal year, such sums as may be necessary
to reimburse the Commodity Credit Corporation for net realized
losses sustained, but not previously reimbursed, pursuant to section
2 of the Act of August 17, 1961 (15 U.S.C. 713a–11)²⁶

At the time of the initial appropriation, no producers had signed up for the program by completing a DCP contract. Producers must re-apply each year.

3. Submission of the DCP contract and documentation of supporting requirements (P) – Farm producers must apply for DCP on an annual basis and can opt out of participating in DCP for any year if they so choose. To be eligible to receive DCP payments, a farm producer must:
 - (a) sign a DCP agreement (Form CCC-509, “Direct And Counter-Cyclical Program Contract”) with the Farm Service Agency (FSA);
 - (b) share in the risk of producing a crop on base acres on a farm enrolled in DCP, and be entitled to share in the crop available for marketing from the base acres or would have shared had a crop been produced;

²⁴ (F) = Feed Grains Program-Level, (P) = Producer-Level

²⁵ <http://www.whitehouse.gov/omb/circulars/a11/04toc.html>

²⁶ Public Law 108-447, p. 118

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- (c) provide a farm operating plan (CCC-502 and related forms);
- (d) report the use of the farm's cropland acreage;
- (e) certify compliance with highly erodible land and wetland conservation requirements on all of their land (form AD-1026);
- (f) comply with planting flexibility requirements;
- (g) use the base acres for agricultural or related activities;
- (h) protect all base acres from erosion, including providing sufficient cover as determined necessary by the county FSA committee, and control weeds;
- (i) certify average adjusted gross income (form CCC-526); and,
- (j) certify the acreage of all cropland on the farm (form FSA-578).

At the time of submission of the DCP contract and documentation of supporting requirements, the producer has formally accepted the terms of the program but the DCP contract has neither been approved nor disapproved by an authorized representative of the CCC.

4. Acceptance of the DCP contract (P) – When the authorized representative from CCC signs the DCP contract, he or she is accepting the terms of the contract. At the time of acceptance of the DCP contract by the CCC, there is a contract between the CCC and the producer that establishes the basis for (a) counter-cyclical payments that will be made in the future should the effective price of feed grains fall below the target price and (b) direct payments that will be made regardless of the market price. These benefits are paid on historically-based acreage and payment yields established for the farm and do not depend on the current production choices of the farmer. The crops do not even need to be planted for the current year to receive payments under the DCP program.
5. Effective price of feed grains falls below target price/Payment (P) – DCP contract counter-cyclical payments are made when the commodity's effective price falls below its target price. When it is projected that the effective price will fall below the target price, FSA initiates the counter-cyclical payment cycle as follows:
 - A first partial payment, based on up to 35 percent of the projected payment rate, is made after October 1 of the year the crop is harvested.
 - A second partial payment, up to 70 percent of the projected payment rate, is made after February 1 of the next calendar year, less any first partial payments already received.
 - A final payment is made after the end of the marketing year.

For crop year 2007, the counter-cyclical payment cycle consists of one partial payment, if authorized, and a final payment.

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Alternative Obligating Events: Feed Grains DCP

Based on the life cycle events discussed above, possible alternative obligating events for the DCP program are:

1. Authorization – The DCP program is authorized until 2007 by the Farm Security and Rural Investment Act of 2002.
2. Appropriation – The Commodity Credit Corporation (and the majority of the programs under its authority, including DCP) receives an annual indefinite appropriation.
3. Birth/Immigration – An individual is born that could potentially one day seek benefits under the DCP program.
4. Submission of the DCP contract and documentation of supporting requirements – To apply for the DCP program, dairy operation producers must submit form CCC-509, "Direct and Counter-Cyclical Program Contract," to the FSA county office where the producer is located. At this time, the producer must have satisfied a myriad of requirements in addition to submission of the DCP contract. At this point, the producer has formally accepted the terms of the program but the DCP contract has not been signed by an authorized representative of the CCC.
5. Acceptance of the DCP contract – An authorized representative of CCC reviews the documentation of supporting requirements, makes a decision to approve or disapprove the contract, and then, if approved, signs the DCP contract.
6. Effective price of feed grains falls below the target price – DCP contract counter-cyclical payments are made when the commodity's effective price falls below its target price.
7. Payment/Due and Payable – Support payments are required to be recognized as liabilities and expenses at the point they become "due and payable." DCP direct payments are recognized as liabilities after the crop is harvested. DCP counter-cyclical payments are recognized as liabilities when the effective price of feed grains falls below the target price, but only for the portion paid at any one time. In other words, if it is estimated as of October 1, that a producer will receive \$100 in counter-cyclical payments for the year, only \$35 (the amount paid as of the first partial payment) is recognized as a liability when paid. The remaining \$65 is not recognized as a liability until paid.

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Discussion of Alternative Obligating Events: Feed Grains DCP

The alternative obligating events identified above are discussed below with respect to the three characteristics required in order to be considered a liability and the two characteristics of a present obligation developed under social insurance. It is important to note that this discussion is based on “current law.” It is recognized that Congress has the ability to change current law at its discretion but accountants usually do not estimate or forecast for possible changes in law unless such changes are imminent.

1. *Authorization*

Discussion

The DCP program is authorized until 2007 by the Farm Security and Rural Investment Act of 2002. At the point of authorization, some could argue that there is an established intent to create an obligation on behalf of the government. However, the ability of accountants to objectively identify and measure intent is limited.

Since no producers had applied for benefits, no event has occurred that would leave the government with little or no discretion to avoid payment of benefits to one or more other entities. Therefore, the point of authorization would appear to fail all three characteristics of a liability.

Summary of Characteristics

At the point of authorization:

- a. There is no present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time the DCP program was authorized in 2002, no producers had met the conditions of the program or were performing under the terms of the program.
 - i. Conditions – Conditions specified by current law to qualify the producers to receive a specific benefit for a specific period of time have not been met. At the point of authorization, no producers had yet met the conditions of the program.
 - ii. Performance – There were no current producers that were performing under the terms of the program at the time of authorization.
- b. Since there is no present duty or responsibility, the government is not left with little or no discretion to avoid the future sacrifice; and
- c. Since there is no present duty or responsibility, the transaction or event has not already happened.

2. *Appropriation*

Discussion

Initial Appropriation – As discussed above, at the point of the initial appropriation, no producers had met the conditions of the program or were performing under the terms of the program. Therefore, since there were no producers yet enrolled in the program and no reasonable reliance placed upon the continued payment of DCP benefits, it would appear

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that there were no entities to which a present obligation had been created that would leave the government little or no discretion to avoid the future sacrifice.

Subsequent Appropriations – The DCP producer must reapply each year and cannot continue receiving payments unless they prove each year that they still meet program conditions established under current law. Some could argue that the continuation of the DCP program (both from the collective viewpoint and an individual's viewpoint) is likely and could set up a scenario where participants become highly reliant on the program, leaving the government little or no discretion to avoid the future sacrifice. However, others could argue that the mere event of appropriation would not create a present obligation for a program that enrolls new participants each year (e.g., student loans and the feed grains DCP program) and for which payment is contingent on occurrence of a specific event (e.g., feed grain prices falling below an established floor).

Summary of Characteristics

At the point of appropriation:

- a. There is no present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand.
 - i. Conditions – Conditions specified by current law to qualify the producers to receive a specific benefit for a specific period of time have not been met. Producers must reapply for DCP benefits each year.
 - ii. Performance – There were no producers that were performing under the terms of the program at the time of appropriation.
- b. Since there is no present duty or responsibility, the government is not left with little or no discretion to avoid the future sacrifice; and
- c. Since there is no present duty or responsibility, the transaction or event has not already happened.

3. *Birth/Immigration*

Discussion

Some could argue that merely being born or immigrating into the United States entitles an individual to certain benefits that have historically been provided over many decades. However, the DCP program is only authorized until 2007 and the continuation of the program is not imminent -- no one born within the last three years (when the program started) would reasonably be relying on the program today or even in 2007 (the proposed end date for the program). In addition, farms that did not have a current production flexibility contract under the 1996 Farm Bill or did not plant covered commodities from 1998-2002 cannot establish a base under the 2002 Farm Bill and would be ineligible for direct and counter-cyclical payments. Therefore, under law that is currently authorized through 2007, at the point of birth or immigration, no individuals have been determined to meet the conditions of the program nor are they performing under the terms of the program. As such, there would be no one relying on the program that would leave the government little or no discretion to avoid the future sacrifice.

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Summary of Characteristics

At the point of birth/immigration:

- a. There is no present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time that individuals are born or immigrate to the United States, none of them have met the conditions of the program nor are they performing under the terms of the program.
 - i. Conditions – Conditions specified by current law to qualify the participants to receive a specific benefit for a specific period of time have not been met. At the point of birth/immigration, no individuals have met the conditions of the program.
 - ii. Performance – There are no current participants that are performing under the terms of the program at the time of birth or immigration.
- b. Since there is no present duty or responsibility, the government is not left with little or no discretion to avoid the future sacrifice; and
- c. Since there is no present duty or responsibility, the transaction or event has not already happened.

4. *Submission of the DCP contract and documentation of supporting requirements*

Discussion

To apply for the DCP program, farm producers must submit form CCC-509, "Direct and Counter-Cyclical Program Contract," to the FSA county office where the operation is located. To be eligible to receive DCP payments, a farm producer must:

- (a) sign a DCP agreement (Form CCC-509, "Direct And Counter-Cyclical Program Contract") with the Farm Service Agency (FSA);
- (b) share in the risk of producing a crop on base acres on a farm enrolled in DCP, and be entitled to share in the crop available for marketing from the base acres or would have shared had a crop been produced;
- (c) provide a farm operating plan (CCC-502 and related forms);
- (d) report the use of the farm's cropland acreage;
- (e) certify compliance with highly erodible land and wetland conservation requirements on all of their land (form AD-1026);
- (f) comply with planting flexibility requirements;
- (g) use the base acres for agricultural or related activities;
- (h) protect all base acres from erosion, including providing sufficient cover as determined necessary by the county FSA committee, and control weeds;
- (i) certify average adjusted gross income (form CCC-526); and,
- (j) certify the acreage of all cropland on the farm (form FSA-578).

Under the current liability standards, liabilities are accrued for the DCP program when "due and payable." Thus, the obligating event occurs when absolutely all conditions necessary for payment have been met. A potential obligating event for the DCP program other than "due and payable" would rely on the fact that remaining unmet conditions are (1) beyond the control of the government under current law and (2) the likelihood that the conditions will remain unmet is remote to varying degrees within the population.

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Some could argue that the obligating event occurs when the producer accepts the terms/conditions of the government's offer. At the time the producer submits the DCP contract and supporting documentation, the producer is accepting the conditions of the program. FAS 88: Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, par. 44, states:

“Statement 74 addressed accounting for special termination benefits whether or not provided through a defined benefit pension plan, that are offered for a short period of time in exchange for employees' voluntary termination of service. The primary conclusion of the Board in Statement 74 was that the cost of special termination benefits should be recognized as a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. That conclusion is incorporated in this Statement. The cost of other termination benefits provided by the existing terms of a plan that are payable only in the event of employees' involuntary termination of service due to a plant closing or a similar event should be recognized when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. The majority of respondents addressing this issue agreed with those conclusions.”

As noted in the paragraph above, in the case of voluntary termination benefits, FASB has determined that a liability should be recognized when the employees accept the offer and the amount can be reasonably estimated. If one were to apply this concept to DCP benefits, one could argue that a liability could be recognized for all direct payments (known quantity and price) at the time that the producer submits the DCP contract and supporting documentation. However, the counter-cyclical payments that are made when the effective price of feed grains falls below the target price would be more difficult to estimate. See staff's discussion of recognition for contingent events below.

Since SFFAS 3 is related to accounting for inventory and related property, it does not address price support programs where the commodities are not purchased. However, SFFAS 3 does require that the estimated amount of contingent losses for commodity purchase agreements²⁷ be recognized as a contingent liability if the loss is more likely than not and measurable.²⁸ Excerpts from SFFAS 5 regarding recognition for contingencies are included on pages 13-15 above.

Staff believes that the recognition criteria for a contingent liability from SFFAS 5 (see excerpt on page 15) is sound. The following points address each of the criteria for recognizing a contingent liability with respect to the DCP program:

1. A past event or exchange transaction has occurred – Staff is proposing that the point of submission of the DCP contract and documentation of supporting evidence is a valid obligating event for the DCP program. Therefore, staff would argue that the first criteria for recognizing a contingent liability is met at that point – the past event (obligating event) has occurred.

²⁷ Commodity purchase agreements are agreements to purchase commodities at a given price at the option of the seller.

²⁸ SFFAS 3 Basis for Conclusion par. 162 noted that “One respondent argued that purchase agreements constitute a contingent liability. The proposed standard would require recognizing a liability and a loss **if the contract price exceeded the expected net realizable value of the commodities**. It is clear that at any given time the market price may be lower than the contract price but that due to cycles in the harvest and post-harvest market this may not be an indication that the contract will be executed and a loss realized. The Board revised the standard to provide for loss recognition in connection with purchase agreements if the loss is both probable and measurable.”

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2. A future outflow or other sacrifice of resources is probable – At the point of submission of the DCP contract and documentation of supporting evidence, it is known that there will be a direct payment made and the amount can be calculated based on the direct payment rate set in current law and the base acres and payment yields established for the farm. Therefore, as long as the producer's documentation is in order, a direct payment will be made. As far as the counter-cyclical payments are concerned, FSA management would be the most appropriate individuals to determine whether, for any given year, counter-cyclical payments are probable based on the effective price falling below the target price established in current law. This could probably be predicted through current trends in the feed grains industry and would most likely differ from year to year. Staff believes that it would not be appropriate for the Board to decide what is probable. The established criteria would be sufficient to guide FSA and its auditors in determining what is probable or not. The draft liability characteristics on page 3 purposely exclude an explicit discussion of probability in order to cast a wide net for designation as a liability. It is up to the Board to decide if they prefer the wide net or a narrower one, and tailor the liability definition accordingly.
3. The future outflow or sacrifice of resources is measurable - At the point of submission of the DCP contract and documentation of supporting evidence, it is known that there will be a direct payment made and the amount can be calculated based on the direct payment rate set in current law and the base acres and payment yields established for the farm. As far as counter-cyclical payments are concerned, FSA management would be the most appropriate individuals to determine whether, for any given year, a drop in the effective price below the target price is measurable. This could probably be predicted through current trends in the feed grains industry and would most likely differ from year to year. Staff believes that it would not be appropriate for the Board to decide what is measurable. The established criteria would be sufficient to guide FSA and its auditors in determining what is measurable or not.

For the reasons cited in the above discussion and current work in other projects, staff feels that the selection of "submission of the DCP contract and documentation of the supporting evidence" would be valid and would not necessitate differentiating between direct payments and counter-cyclical payments. The criteria for recognition and measurement would be established in such a way that the most appropriate individuals (agency management) could determine which of their programs meet the recognition and measurement criteria.

Finally, one additional consideration for this potential obligating event is that, at the point that the DCP contract is submitted, it has not been formally ratified or approved by an authorized representative from CCC. However, that technicality would not necessarily prevent CCC from being legally obligated to pay the benefits if the producers met all conditions of the program and performed under the terms of the contract (see discussion of the potential obligating event of "Acceptance of the DCP contract" below).

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At the point of submission of the DCP contract and documentation of supporting requirements:

- a. There is a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time that the producers submit the DCP contract and documentation of supporting requirements, they are accepting the terms of the program.
 - i. Conditions – Conditions specified by current law to qualify the participants to receive a specific benefit for a specific period of time have been met. At the point of submission of the DCP contract and supporting requirements, the performers have met the conditions established by the government for the DCP program. All that remains is for the authorized representative to verify the supporting information and sign the DCP contract.
 - ii. Performance – As the producers continue to share in the risk of producing a crop on base acres on a farm enrolled in DCP; comply with planting flexibility requirements; use the base acres for agricultural or related activities; protect all base acres from erosion, including providing sufficient cover as determined necessary by the county FSA committee; control weeds; and, meet the Highly Erodible Land Conservation and Wetland Conservation provisions, they are performing under the terms of the program.
- b. Since there are producers that have met the conditions of the program, accepted the terms of the program, and continue to perform under the conditions of the program, the government is left with little or no discretion to avoid the future sacrifice; and
- c. The transaction or event has already happened that leaves the government little or no discretion to avoid the future sacrifice of resources to these producers that have applied for benefits.

5. Acceptance of the DCP contract

Discussion

At the point of acceptance of the DCP contract, an authorized representative of the CCC is making a uniform decision as to whether to accept or reject a producer into the DCP program based on the conditions of the program. This action in and of itself is not considered to be the obligating event; if one accepts staff's discussion in the previous point of submission of the DCP contract and documentation of supporting requirements, the obligating event is considered to have already occurred.

In its discussion of the SSI program at the March 2005 Board meeting, several Board members were uncomfortable with inserting the government determination or approval as a required step in the process. It was felt that, if the government laid out the conditions of the program, and there were individuals out there who met the conditions of the program, the government could have a liability, exclusive of the fact of whether the government had verified that the individuals had, in fact, met the conditions of the program.

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Summary of Characteristics

At the point of acceptance of the DCP contract:

- a. There is a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time that the DCP contract is accepted by an authorized representative of the CCC, the producer is accepted into the DCP program, creating an expectation on the part of the producer that support payments will continue as long as the producer continues to meet the conditions of the program and performs under the terms of the program, thus leaving the government little or no discretion to avoid the future sacrifice.
 - i. Conditions – Conditions specified by current law to qualify the producers to receive a specific benefit for a specific period of time have been met. At the point of acceptance of the DCP contract, the producers have met the conditions to enable them to begin receiving payments under the DCP program.
 - ii. Performance – The producers begin performing under the terms of the program by successfully submitting a DCP contract and documentation of supporting requirements. They continue to perform under the terms of the program by sharing in the risk of producing a crop on base acres on a farm enrolled in DCP; complying with planting flexibility requirements; using the base acres for agricultural or related activities; protecting all base acres from erosion, including providing sufficient cover as determined necessary by the county FSA committee; controlling weeds; and, meeting the Highly Erodible Land Conservation and Wetland Conservation provisions, they are performing under the terms of the program.
- b. The present duty or responsibility obligates the government under current law, leaving it with little or no discretion to avoid the future sacrifice; and
- c. The transaction or event has already happened at the point of acceptance of the DCP contract.

6. *Effective price of feed grains falls below the target price*

Discussion

DCP contract counter-cyclical payments are made when the commodity's effective price falls below its target price. When it is projected that the effective price will fall below the target price, FSA initiates the counter-cyclical payment cycle as follows:

- A first partial payment, based on up to 35 percent of the projected payment rate, is made after October 1 of the year the crop is harvested.
- A second partial payment, up to 70 percent of the projected payment rate, is made after February 1 of next calendar year, less any first partial payments already received.
- A final payment is made after the end of the marketing year.

For crop year 2007, the counter-cyclical payment cycle consists of one partial payment, if authorized, and a final payment.

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The counter-cyclical payment amount is computed from the historical base acres and payment yields established for the farm. This information is known; the unknown is when the effective price for any given commodity will fall below its target price. Producers must refund to FSA counter-cyclical payments that exceed the actual counter-cyclical payment for each respective crop. This situation may occur when actual market prices exceed the projected market prices used in determining the partial counter-cyclical payment rates.

Summary of Characteristics

At the point the effective price of feed grains falls below the target price:

- a. There is a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time that the effective price of feed grains falls below the target price, there is an expectation on the part of the producer that he will receive that payment provided that he has submitted all required documentation.
 - i. Conditions – Conditions specified by current law to qualify the participants to receive a specific benefit for a specific period of time have been met. At the point the effective price of feed grains falls below the target price, the producers have met the conditions of the program that enable them to receive the appropriate counter-cyclical payment for their established base acres and payment yield.
 - ii. Performance – The participants are performing under the terms of the program. The producers are sharing in the risk of producing a crop on base acres on a farm enrolled in DCP; complying with planting flexibility requirements; using the base acres for agricultural or related activities; protecting all base acres from erosion, including providing sufficient cover as determined necessary by the county FSA committee; controlling weeds; and, meeting the Highly Erodible Land Conservation and Wetland Conservation provisions, they are performing under the terms of the program.
- b. The present duty or responsibility obligates the government under current law, leaving it with little or no discretion to avoid the future sacrifice; and
- c. The transaction or event has already happened at the point the effective price of feed grains falls below the target price.

7. Payment/Due and Payable

Discussion

Under the current liability standards set forth in SFFAS 5,²⁹ support payments are recognized as liabilities and expenses at the point they become “due and payable.” DCP direct payments are recognized as liabilities after the crop is harvested. IDCP counter-cyclical payments are recognized as liabilities when the effective price of feed grains falls below the target price, but only for the portion paid at any one time. In other words, if it is estimated as of October 1, that a producer will receive \$100 in counter-cyclical payments for the year, only \$35 (the amount paid as of the first partial payment) is recognized as a

²⁹ SFFAS 3, Accounting for Inventory and Related Property, par. 92 – 109, address Goods Held Under Price Support and Stabilization Programs. The MILC program does not purchase or hold goods; it provides a subsidy payment, and is therefore, not addressed under this standard.

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liability when paid. The remaining \$65 is not recognized as a liability until paid. These due and payable benefits are legally enforceable under current law if unduly withheld.

Summary of Characteristics

At the point of due and payable:

- a. There is a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. At the time that a payment is due and payable, an expectation on the part of the producer that he will receive that payment is backed by the legal enforceability of that expectation if the benefits are unduly withheld.
 - i. Conditions – Conditions specified by current law to qualify the participants to receive a specific benefit for a specific period of time have been met. At the point of due and payable, all conditions necessary for payment (terms of the program) have been met.
 - ii. Performance – The producers are performing under the terms of the program.
- b. The present duty or responsibility obligates the government under current law, leaving it with little or no discretion to avoid the future sacrifice; and
- c. The transaction or event has already happened at the point of due and payable.

* * * * *

The three alternative obligating events to due and payable that seem plausible based on the discussion above are:

- Submission of the DCP contract and documentation of supporting requirements (for both direct and counter-cyclical contract payments)
- Acceptance of the DCP contract (for both direct and counter-cyclical contract payments)
- Effective price of feed grains falls below the target price (for counter-cyclical contract payments only)

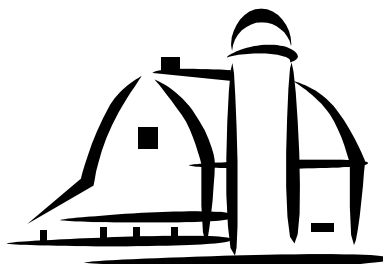
It is important to note that a Board member's preference for any of the three alternative obligating events above would have no bearing on the point at which benefits become legally enforceable. As with Social Insurance benefits, no payments are legally enforceable under current law until due and payable, regardless of when they are first recognized in financial reports. Agreeing on an earlier obligating event will not enable individuals to lay claim to benefits before all necessary conditions of the program have been met. However, accruing an expense and accumulating a liability on the Federal balance sheet, which is a primary means of communicating how the government's financial position has improved or deteriorated over the period, as producers accept the terms of the DCP program would focus management's attention on the economic costs of the promises being made.

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Staff Recommendation: Feed Grains DCP

Staff believes that, if one accepts the argument of “little or no discretion to avoid the present obligation” as being the essence of a liability, or alternatively, “Under existing conditions, the federal entity is required to settle the obligation at a specified or determinable date, when a specified event occurs, or on demand,” there is a strong argument for the point of submission of the DCP contract and documentation of supporting requirements as being a valid alternative obligating event to due and payable for the feed grains DCP program. Once a producer meets and accepts the terms of the program under current law, the producer can anticipate receiving benefits until such time that he no longer meets the conditions of the program and performs under the terms of the program.

<p style="text-align: center;">Do you agree with staff’s recommendation of the obligating event for Feed Grains DCP program being at the point of submission of the DCP contract and documentation of supporting requirements?</p>



Farm Service Agency (FSA)

The Farm Service Agency (FSA) of the U.S. Department of Agriculture ensures the well-being of American agriculture, the environment and the American public through efficient and equitable administration of farm commodity programs; farm ownership, operating and emergency loans; conservation and environmental programs; emergency and disaster assistance; domestic and international food assistance and international export credit programs.³⁰

FSA was established October 3, 1994, pursuant to the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994, P.L. 103–354. The Department of Agriculture Reorganization Act of 1994 was amended on April 4, 1996, by the Federal Agriculture Improvement and Reform Act of 1996 (1996 Act), P.L. 104–127. The FSA administers a variety of activities, such as farm income support programs through various loans and payments; the Conservation Reserve Program (CRP); the Emergency Conservation Program; the Hazardous Waste Management Program; the Commodity Operation Programs including the warehouse examination function; farm ownership, farm operating, emergency disaster, and other loan programs; price support and production control programs for tobacco and peanuts; and the Noninsured Crop Disaster Assistance Program (NAP), which provides crop loss protection for growers of many crops for which crop insurance is not available. The Agency also assists in the administration of several conservation cost-share programs financed by the Commodity Credit Corporation (CCC), including the Grasslands Reserve Program (GRP). In addition, FSA currently provides certain administrative support services to the Foreign Agricultural Service (FAS) and to the Risk Management Agency (RMA).³¹

FSA's farm programs provide an economic safety net through farm income support to eligible producers, cooperatives, and associations to help improve the economic stability and viability of the agricultural sector and to ensure the production of an adequate and reasonably priced supply of food and fiber. Objectives of FSA include providing direct and counter-cyclical payments, providing marketing assistance loans and loan deficiency payments enabling recipients to continue farming operations without marketing their product immediately after harvest, stabilizing the price and production of tobacco through 2005, and providing a financial assistance safety net to eligible producers when natural disasters result in a catastrophic loss of production or prevent planting of noninsured crops, and timely approval of crop prices, average yields, and payment factors for the Noninsured Crop Disaster Assistance Program (NAP).³²

Farm program activities include the following functions dealing with the administration of programs carried out through the farmer committee system of the FSA: (a) developing program regulations and procedures; (b) collecting and compiling basic data for individual farms; (c) establishing individual farm allotments for farm planting history; (d) notifying producers of established allotments and farm planting histories; (e) establishing individual farm

³⁰ http://www.fsa.usda.gov/pas/about_fsa/mission.htm

³¹ Budget of the United States Government, Fiscal Year 2006—Appendix, p. 101

³² Budget of the United States Government, Fiscal Year 2006—Appendix, pp. 101-102

allotments and determining farm marketing quotas for tobacco through 2005; (f) conducting referendums and certifying results; (g) accepting farmer certifications and checking compliance for specific purposes; (h) issuing marketing cards so that production from the allotted acreage can be marketed without penalty; (i) processing commodity loan documents and issuing checks; (j) processing direct and counter-cyclical payments and issuing checks; (k) certifying payment eligibility and monitoring payment limitations; and (l) processing farm storage facility loans and issuing checks.³³

The two FSA programs selected for review in this paper are the Milk Income Loss Contract (MILC) program and the Feed Grains Direct and Counter-Cyclical Payment (DCP) program. These programs are authorized by the Commodity Credit Corporation (CCC) and administered by FSA. The CCC is a government corporation with no operating personnel; FSA personnel handle the operations of the CCC under the authority granted to the CCC.³⁴ See Appendix 2 for more information on CCC.

³³ Budget of the United States Government, Fiscal Year 2006—Appendix, p. 102

³⁴ The Commodity Credit Corporation (CCC) is a Government-owned and operated entity that was created to stabilize, support, and protect farm income and prices. CCC also helps maintain balanced and adequate supplies of agricultural commodities and aids in their orderly distribution. CCC was incorporated October 17, 1933, under a Delaware charter with a capitalization of \$3 million. It was initially managed and operated in close affiliation with the Reconstruction Finance Corporation, which funded its operations. On July 1, 1939, CCC was transferred to the United States Department of Agriculture (USDA). It was reincorporated on July 1, 1948, as a Federal corporation within USDA by the Commodity Credit Corporation Charter Act (62 Stat.1070; 15 U.S.C. 714). CCC has no operating personnel. Its price support, storage, and reserve programs, and its domestic acquisition and disposal activities are carried out primarily through the personnel and facilities of the Farm Service Agency (FSA). For more information on the CCC, see the fact sheet located at <http://www.fsa.usda.gov/pas/publications/facts/html/cc99.htm>.



Commodity Credit Corporation (CCC)

The Commodity Credit Corporation (CCC) was created to: stabilize, support, and protect farm income and prices; help maintain balanced and adequate supplies of agricultural commodities, their products, foods, feeds, and fibers; and help in their orderly distribution. The Corporation's capital stock of \$100 million is held by the U.S. Treasury. Under present law, up to \$30 billion may be borrowed from the U.S. Treasury to finance operations.

Current, indefinite appropriation authority is requested to cover all net realized losses. Appropriations to the Corporation for net realized losses have no effect on budget authority, as they are used to repay debt directly with the Treasury. It is difficult to accurately forecast program requirements in advance since the projections are subject to complex and unpredictable factors such as weather, other factors which affect the volume of production of crops not yet planted, feed and food needs here and overseas, and the available dollar exchange.

Appropriations are made to reimburse the Corporation for net realized losses sustained in carrying out its operations. The Farm Security and Rural Investment Act of 2002 provided a total of \$176 billion for payments to the farm sector, a 74 percent increase over the assistance the previous Farm Bill would have provided in the absence of any additional emergency assistance. Not all of this assistance is appropriately targeted, and many of the programs may need to be reformed as a result of any new multilateral long-term trade agreements. Therefore, the Administration is proposing the following legislative changes to reduce agricultural subsidies, promote more efficient production decisions, and extend expiring programs:

- Reduce the payment limit cap for individuals to \$250,000 for crop payments, including all types of marketing loan gains, while removing the three-entity-rule.
- Base marketing loans on historical production.
- Reduce crop and dairy payments to farmers by 5 percent. Payments to farmers from all commodity programs (e.g. marketing loans, direct and counter-cyclical payments) would be calculated and payments would be reduced by 5 percent.
- Require the dairy price support program to minimize expenditures.
- Add a sugar marketing assessment to be paid by sugar processors on all processed sugar.
- Extend the Milk Income Loss Contract program for two years.

Programs under the CCC include price support, marketing assistance loans, and related stabilization programs; direct and counter-cyclical payments; marketing assessments; market loss assistance payments; disaster payments; and conservation programs.

The CCC has no operating personnel. Its price support, storage, and reserve programs, and its domestic acquisition and disposal activities are carried out primarily through the personnel and facilities of the Farm Service Agency (FSA).³⁵ See Appendix 1 for more information on FSA.

³⁵ Source: Budget of the United States Government, Fiscal Year 2006—Appendix, pp. 110-113. For more information on the CCC, see the fact sheet located at <http://www.fsa.usda.gov/pas/publications/facts/html/cc99.htm>.

Milk Income Loss Contract (MILC) Program



Most information was obtained from various document links at <http://www.fsa.usda.gov/dafp/psd/MILC.htm> as of March/April 2005. Hard copies of documents as of that timeframe are maintained in the project file.

Summary³⁶

The U.S. Department of Agriculture (USDA) Farm Service Agency's (FSA) Milk Income Loss Contract (MILC) Program financially compensates dairy producers when domestic milk prices fall below a specified level. The program is authorized by the Farm Security and Rural Investment Act of 2002³⁷ (Farm Act) and has no set funding level. The Farm Act was enacted May 13, 2002 and authorized payments retroactively beginning with December 1, 2001. Regulations governing the administration of the MILC program are provided in 7 CFR Part 1430.

This program is separate from the following three other dairy programs operated by FSA:

- the Milk Price Support Program (MPSP) where FSA purchases butter, Cheddar cheese, and nonfat dry milk from producers to provide farmers a parity level of income;³⁸
- the Dairy Indemnity Payment Program where FSA makes payments to dairy producers when a public regulatory agency directs them to remove their raw milk from the commercial market because it has been contaminated by pesticides, nuclear radiation or fallout, or toxic substances and chemical residues other than pesticides;³⁹ and,
- the Dairy Export Incentive Program (DEIP) where dairy commercial exporters can apply for cash subsidies to offset the difference between world and U.S. prices. This can lower the amount of MPSP purchases or increase U.S. Government market removals. FSA pays the DEIP subsidies, but does not actually purchase the exported commodities.⁴⁰

In addition to the FSA dairy programs mentioned above, USDA's Agricultural Marketing Service (AMS) issues Federal Milk Marketing Orders that establish the minimum prices that handlers are required to pay for milk purchased from producers. The purpose of the Federal Milk Marketing Orders program is to assure dairy farmers a reasonable minimum price for their milk throughout the year and assure consumers of an adequate supply of milk to meet their needs throughout the year and help prevent wild fluctuations in price through periods of heavy and light milk production.

³⁶ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm> and MILC Handbook 11-LD

³⁷ Public Law 107-171, Sec. 1502

³⁸ <http://www.fsa.usda.gov/pas/publications/facts/html/MPSP04.htm>

³⁹ <http://www.fsa.usda.gov/pas/publications/facts/html/dipp03.htm>

⁴⁰ <http://www.fsa.usda.gov/pas/publications/facts/html/MPSP04.htm>

Eligible Dairy Producers⁴¹

Eligible dairy producers are those who, beginning December 1, 2001, through September 30, 2005:

- commercially produce and market cow milk in the United States; or
- produce milk in the United States and commercially market the milk outside the United States.

Dairy producers from a foreign country who have a working visa or other valid taxpayer identification number are eligible for MILC benefits.

According to the Farm Act, the term “producer” means an individual or entity that directly or indirectly shares in the risk of producing milk and makes contributions (including land, labor, management, equipment, or capital) to the dairy farming operation of the individual or entity that are at least commensurate with the share of the individual or the entity of the proceeds of the operation. A person is not considered to be an eligible producer if he is not a citizen of or legal resident alien in the United States; does not directly share in the risk or make contributions to the production of milk; is not part of an eligible dairy operation; violates Highly Erodible Land Conservation or Wetland Conservation provisions; and/or is convicted under Federal or State law of a controlled substance violation.

To be eligible to receive MILC payments, a dairy operation must:⁴²

- (a) Have produced milk in the United States and commercially marketed the milk produced anytime during the period of December 1, 2001, through September 30, 2005;
- (b) Enter into a MILC during the contract application period;
- (c) Agree to all terms and conditions in the MILC and comply with instructions issued by the Commodity Credit Corporation (CCC). The CCC is a government corporation with no operating personnel; FSA personnel handle the operations of the CCC under the authority granted to the CCC;⁴³
- (d) Provide proof of monthly milk production commercially marketed by all persons in the dairy operation during the contract period to determine the total pounds of milk that will be converted to hundredweight (cwt.) used for payment;
- (e) Submit evidence of production in a timely manner;
- (f) Be actively engaged in the business of producing and marketing agricultural products at the time of signing the MILC.

⁴¹ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>; Public Law 107-171, Sec. 1502; and, MILC Handbook 11-LD

⁴² Federal Register Vol. 67, No. 202, §1430.203

⁴³ The Commodity Credit Corporation (CCC) is a Government-owned and operated entity that was created to stabilize, support, and protect farm income and prices. CCC also helps maintain balanced and adequate supplies of agricultural commodities and aids in their orderly distribution. CCC was incorporated October 17, 1933, under a Delaware charter with a capitalization of \$3 million. It was initially managed and operated in close affiliation with the Reconstruction Finance Corporation, which funded its operations. On July 1, 1939, CCC was transferred to the United States Department of Agriculture (USDA). It was reincorporated on July 1, 1948, as a Federal corporation within USDA by the Commodity Credit Corporation Charter Act (62 Stat.1070; 15 U.S.C. 714). CCC has no operating personnel. Its price support, storage, and reserve programs, and its domestic acquisition and disposal activities are carried out primarily through the personnel and facilities of the Farm Service Agency (FSA). For more information on the CCC, see the fact sheet located at <http://www.fsa.usda.gov/pas/publications/facts/html/cc99.htm>.

Sign-up⁴⁴

Sign-up for the MILC program began August 13, 2002, and ends September 30, 2005. Eligible dairy producers can apply for program benefits anytime during this sign-up period.

How to Apply⁴⁵

To apply for the MILC program, dairy operation producers must submit form CCC-580, "Milk Income Loss Contract," to the FSA county office where the dairy operation is located. The form is available online at <http://forms.sc.egov.usda.gov/eforms/mainervlet> or from FSA offices. This form is a contract, signed by the participant producer and an authorized representative for the CCC who either approves or disapproves the contract.⁴⁶

The CCC-580 must show the total pounds of all milk produced and marketed during each month for all persons receiving a share of the marketed milk. Monthly milk production may not be apportioned to circumvent the maximum payment quantity. All persons who share in the risk of a dairy operation's total production must certify the information on the CCC-580. FSA will accept only one CCC-580 per operation.

When applying for a MILC contract, operators must also have on file:

- Form AD-1026, "Highly Erodible Land Conservation and Wetland Conservation Certification," used to certify understanding of the conservation compliance requirements under USDA programs; and
- Form SF-1199A, "Direct Deposit Sign Up Form," used to sign up for the direct deposit of payments into the payee's account.

These forms are available online at: <http://forms.sc.egov.usda.gov/eforms/mainervlet> or from FSA offices.

Production Evidence⁴⁷

Before MILC payments are issued, all persons involved in a single dairy operation must provide evidence of eligible marketings. Verifiable production evidence can include:

- milk marketing payment stubs;⁴⁸

⁴⁴ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>

⁴⁵ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>

⁴⁶ It is important to note that paragraph 19B of the contract appendix states "CCC agrees, **subject to the availability of funds**, to pay to the participant, to the extent required by the applicable CCC regulations, the agreed upon monthly payment, based upon the shares to which the parties have agreed as set forth on Form CCC-580 for a period of years not in excess of the contract period." [emphasis added] The inclusion of a funds availability clause provides CCC a legal "out" for making payments when appropriations are not available for such payments. The appendix can be found at <http://forms.sc.egov.usda.gov/eforms/mainervlet>.

⁴⁷ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>

⁴⁸ The milk marketing chain that moves milk from the dairy farm to the consumer is composed of farmers, dairy cooperatives, wholesale milk processors, and retailers, and entities at each level receive a portion of the retail price of a gallon of milk for the functions they perform. These functions include producing, processing, distributing, and selling milk. During 2002 and 2003, farm prices were the lowest since 1979, while retail milk prices generally did not experience a similar decline. This disparity raised concerns about a growing price spread between farm and retail milk prices. However, in 2004, farm price trends have reversed, with farm prices reaching record highs (GAO Report GAO-05-50, Dairy Industry – Information on Milk Prices, Factors Affecting Prices, and Dairy Policy Options).

Appendix 3 – MILC Fact Sheet

- tank records;
- milk handler records;
- daily milk marketings; and
- copies of any payments received as compensation from other sources.

FSA county offices have 60 calendar days from receiving the production evidence to issue payments.

Ineligible Milk Production⁴⁹

The following are not considered commercially marketed milk and are ineligible production for the MILC program:

- dumped milk that causes the contamination of a bulk load for which an insurance indemnity is paid to the producer for the contaminated milk; and
- milk dumped on the farm by a state or health department order.

Types of Payments⁵⁰

There are two types of payments available to eligible dairy operations under the MILC program:

- monthly contract payments
- transition period payments

MILC monthly contract payments are payments issued during the months following the transition period. MILC transition period payments are payments issued for the period from December 1, 2001, until the time the dairy operation enters into a CCC-580 with CCC.

Monthly Contract Payments

MILC contract payments are made on a monthly basis when the Boston Class I milk⁵¹ price falls below \$16.94 per hundredweight (cwt). The monthly Boston price is posted online at: http://www.fmmone.com/Northeast_Order_Prices/NE_Prices_main_new.htm#Advance. The Boston Class I fluid milk price is announced to the public the Friday on or before the 23rd of each month (e.g., the announcement for June 2005 should be posted no later than Friday, May 20, 2005).

When the Boston milk price exceeds \$16.94 per cwt⁵²:

- no payments will be made to the dairy operation; and
- production for that month will not count towards the operation's maximum eligible production.

Payments are issued up to a maximum of 2.4 million pounds of milk produced and marketed by the operation per fiscal year. Payments are issued no later than 60 calendar days after FSA receives production evidence for the applicable month.

⁴⁹ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>

⁵⁰ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm> and MILC Handbook 11-LD

⁵¹ Per Federal Register Vol. 67, No. 202, §1430.202, Class I Milk is defined as milk, including milk components, classified as Class I milk under a Federal milk marketing order.

⁵² This rate was established in Public Law 107-171, Sec. 1502.

Transition Period Payments⁵³

Dairy producers may also receive payments on milk marketed from December 1, 2001, through the last day of the month preceding the month the operation's MILC contract is submitted. Transition payments are paid in a lump sum based on eligible production up to 2.4 million pounds in any year in the transition period.⁵⁴ This lump sum payment is in addition to the future payments to be received from the point the contract is signed.⁵⁵ The transition period lasts from December 1, 2001, until the time the operation enters into the contract. For example:

- a dairy operation signs contract on November 15, 2002;
- FSA approves and signs contract on November 30, 2002;
- the transition period for dairy operation is December 1, 2001, through October 31, 2002.

Dairy operations that go out of business after December 1, 2001, may receive transition payments on the first 2.4 million pounds of eligible production commercially marketed during the transition period.

Forgoing Transition Payments⁵⁶

During fiscal year 2002 only, dairy operators may have elected to forgo their transition payments and instead receive a fiscal year 2002 payment for the month of September (the only month remaining in the fiscal year). Operations that chose this option must, by August 30, 2002, have selected September as the starting month to begin receiving payments for fiscal year 2002.

Once dairy operation producers selected this option, fiscal year 2002 payments were made at the September 2002 payment rate and were based on production during that month. These dairy operations were not paid for August 2002 (the month the operator made a contract offer).

The option to forgo the transition period payment is not available during fiscal years 2003-2005.

⁵³ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm> and Federal Register Vol. 67, No. 202, §1430.208

⁵⁴ Some producers filed a lawsuit contesting USDA's interpretation of the volume limit on MILC transition program payments of 2.4 million. According to USDA answers to questions submitted by Representative Charles Stenholm (Texas) regarding "The State Of The Dairy Industry Hearing before the Subcommittee on Department Operations, Oversight, Nutrition, And Forestry of the Committee On Agriculture House Of Representatives" (One Hundred Eighth Congress First Session May 20, 2003), "The United States District Court for the Northern District of Ohio, Eastern Division, issued a decision in *Fullenkamp, et al., v. Veneman* on May 19, 2003, granting the Government's dispositive summary judgment motion in full and denying plaintiffs' motion for injunctive relief. Plaintiffs were large dairy producers challenging the Department of Agriculture's implementation of the Milk Income Loss Compensation Assistance (MILC) Program. Specifically they challenged whether the production cap of 2,400,000 pounds in section 1502(d)(2) of the Farm Security and Rural Investment Act of 2002, which authorized the MILC Program, should be applied to transition payments, that is for payments made from December 1, 2001 through the month preceding the month the dairy producers entered into the MILC Program contract. The Judge found the statutory language was ambiguous on the question whether the production cap of 2,400,000 pounds should be applied to transition payments, and then found the Department of Agriculture's application of the cap in its regulation to be a permissible statutory construction that deserved judicial deference. She dismissed the plaintiffs' secondary challenges with respect to the timing of the transition and contract payments for lack of standing. Plaintiffs have filed [sic] a notice of appeal." In *Fullenkamp v. Veneman*, No. 03-3731, 2004 WL 1948759 (6th Cir. Sept. 2, 2004), the United States Court of Appeals for the Sixth Circuit held that the regulations that limited the amount of transition payments received by dairy producers under the Milk Loss Contract Program were valid.

⁵⁵ Public Law 107-171, Sec. 1502(h)

⁵⁶ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>

Fiscal Year 2002 Post Transition Period⁵⁷

If a MILC contract was entered into during fiscal year 2002 (August 13, 2002 through September 30, 2002) and the operation reached the production cap during the transition period (December 1, 2001, through either July 31, 2002 or August 31, 2002), no additional fiscal year 2002 payments were earned.

If the operation did not reach the maximum eligible production cap by the end of the transition period, payments continued for the month the contract was submitted to FSA (August 2002) and subsequent months thereafter until the earlier of:

- the 2.4 million maximum eligible production cap was reached; or
- the end of the 2002 fiscal year.

Fiscal Years 2003-2005 Post Transition Period⁵⁸

Transition period payments may carry over into multiple fiscal years (2003-2005) depending on the date the dairy operation producers sign a MILC contract. If the transition period carries over and a start month is not designated, then a payment is issued for the month a contract was submitted. For example:

- Dairy A submits a contract to FSA on December 11, 2002. Therefore:
 - the transition period is December 1, 2001, through November 30, 2002;
 - Dairy A will receive a fiscal year 2002 transition payment for December 1, 2001, through the earlier of the date the maximum eligible quantity is reached or the end of fiscal year 2002.
- The transition period carries over to another fiscal year. Therefore:
 - the transition period payment will continue in fiscal year 2003;
 - Dairy A will continue receiving transition payments in fiscal year 2003 for the months of October and November.
- Dairy A chooses not to designate a start month. Therefore:
 - Dairy A's payment will start in December (the month Dairy A submitted a contract) and continue through the earlier of the date the maximum payment quantity is reached or the end of fiscal year.

An operation can also designate a month to start receiving payments. For example:

- Dairy B also submits a contract to FSA on December 11, 2002, and the transition period carries over to another fiscal year.
- Dairy B then designates March 2003 as the month to begin receiving payments. Therefore:
 - after transition payments are received for October and November, fiscal year 2003 payments will cease and resume in March 2003;
 - payments will be issued consecutively thereafter until the earlier of the date the maximum payment quantity is reached or the end of fiscal year.

⁵⁷ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>

⁵⁸ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>

Maximum Eligible Quantity⁵⁹

No producer will receive payment for more than 2.4 million pounds of production in any given fiscal year. Milk production produced during any fiscal year will not count towards a dairy operation's maximum eligible quantity of 2.4 million pounds per dairy operation for months during that fiscal year:

- when the Boston Class I price exceeds \$16.94 per cwt, and there is no payment rate for that month
- that precede the MILC start month designated on CCC-580 for the applicable fiscal year.

Payment Rate Calculation⁶⁰

Payment rates are determined by multiplying 45 percent of the difference between \$16.94 and the Boston Class I (BC I) price for that month.⁶¹ For example:

BC I price announced in October 2002 = \$13.40
\$16.94 - \$13.40 = \$3.54
\$3.54 x 45 percent = \$1.5930000
Payment rate for October 2002 = \$1.5930000 per cwt

The payment amount to each producer is then calculated by multiplying the payment rate times the eligible production for the producer for that month.⁶² For example:

Payment rate for October 2002 = \$1.5930000
Eligible production for October 2002 = 100,000 pounds (100 cwt)
100 cwt X \$1.5930000 per cwt = \$1,593
Payment amount for October 2002 = \$1,593

⁵⁹ <http://www.fsa.usda.gov/dafp/psd/MILC.htm> - Notices LD-540 Changing MILC Start Month Selection for Upcoming Fiscal Year

⁶⁰ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>

⁶¹ Class I price @ Suffolk County, MA (Boston) at 3.5% butterfat (excludes processor assessment)

⁶² See payment calculator at <http://www.fsa.usda.gov/dafp/psd/MILC.htm#Payment%20Calculator>.

Payment Rates⁶³

Payment rates for December 2001 through April 2005 are as follows:

December 2001	\$0.7695000	September 2003	\$0.0000000
January 2002	\$0.7785000	October 2003	\$0.0000000
February 2002	\$0.7830000	November 2003	\$0.0000000
March 2002	\$0.9315000	December 2003	\$0.0000000
April 2002	\$0.9990000	January 2004	\$0.8280000
May 2002	\$1.0935000	February 2004	\$0.9450000
June 2002	\$1.1970000	March 2004	\$0.7875000
July 2002	\$1.3815000	April 2004	\$0.0225000
August 2002	\$1.4445000	May 2004	\$0.0000000
September 2002	\$1.4535000	June 2004	\$0.0000000
October 2002	\$1.5930000	July 2004	\$0.0000000
November 2002	\$1.3905000	August 2004	\$0.0000000
December 2002	\$1.4265000	September 2004	\$0.0000000
January 2003	\$1.4085000	October 2004	\$0.0000000
February 2003	\$1.5570000	November 2004	\$0.0000000
March 2003	\$1.7460000	December 2004	\$0.0000000
April 2003	\$1.8225000	January 2005	\$0.0000000
May 2003	\$1.7910000	February 2005	\$0.0000000
June 2003	\$1.7775000	March 2005	\$0.0000000
July 2003	\$1.7640000	April 2005	\$0.0000000
August 2003	\$1.2240000		

Payment rates are rounded seven places to the right of the decimal. FSA posts monthly MILC payment rates on FSA's Web site at <http://www.fsa.usda.gov/dafp/psd/MILC.htm>. The Federal milk orders that announce the monthly Boston Class I milk price and are used to calculate the MILC payment rates are posted online at: http://www.fmmone.com/Northeast_Order_Prices/NE_Prices_main_new.htm#Advance. A sample Federal milk order is included on the following two pages.

⁶³ Payment rates through November 2002 were obtained directly from <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>. Payment rates beginning in December 2002 were calculated by staff using the milk price announcements at <http://www.fsa.usda.gov/dafp/psd/MILC.htm>.

**Sample Federal Milk Order
Announcement of Class I Price and Advanced Pricing Factors**



Agricultural Marketing Service
Dairy Programs

**FEDERAL MILK ORDER No. 1
Northeast Marketing Area**

89 South Street, Boston, MA 02111-2671
Mailing Address:
P.O. Box 51478
Boston, MA 02205-1478
Tel.: (617) 737-7199 — Fax: (617) 737-8002
email: MABoston@fedmilk1.com
website: www.fmmone.com

Albany:
One Columbia Circle
Albany, NY 12203-8379
Tel.: (518) 452-4410
Fax: (518) 484-8488
email: MAAlbany@fedmilk1.com

Alexandria:
P.O. Box 25828
Alexandria, VA 22313-5828
Tel.: (703) 549-7000
Fax: (703) 549-7003
email: MAAlexandria@fedmilk1.com

ANNOUNCEMENT OF CLASS I PRICE AND ADVANCED PRICING FACTORS

	April 2005 (dollars)	
Class I price @ <i>Suffolk County, MA (Boston)</i> at 3.5% butterfat	17.38	per hundredweight
Processor Assessment ^{1/}	0.20	per hundredweight
Total Class I price	17.58	per hundredweight
Class I skim price @ <i>Boston, MA</i>	11.60	per hundredweight
Class I butterfat price @ <i>Boston, MA</i>	1.7684	per pound
Class I skim price @ <i>New York, NY</i>	11.50	per hundredweight
Class I butterfat price @ <i>New York, NY</i>	1.7674	per pound
Class I skim price @ <i>Philadelphia, PA</i>	11.40	per hundredweight
Class I butterfat price @ <i>Philadelphia, PA</i>	1.7664	per pound
Class II skim price	7.54	per hundredweight
Class II nonfat solids price	0.8378	per pound
Advanced pricing factors:		
Base skim milk price for Class I	8.35	per hundredweight
Advanced butterfat pricing factor	1.7359	per pound
Advanced Class III skim milk pricing factor	8.35	per hundredweight
Advanced Class IV skim milk pricing factor	6.84	per hundredweight
<hr/>		
Two-week product price averages (weeks ending 3/5, 3/12):	March 2005 (dollars)	
Butter	1.5616	per pound
Nonfat dry milk	0.9073	per pound
Cheese	1.5140	per pound
Dry whey	0.2485	per pound

^{1/} The processor assessment is an obligation under the Fluid Milk Promotion Order (7CFR§1160.101 *et seq.*). The Order requires that all persons who process and market commercially more than 3,000,000 pounds of fluid milk products in consumer-type packages in the 48 contiguous states and District of Columbia on a monthly basis, excluding those fluid milk products delivered to a residence of a consumer, be assessed 20 cents per hundredweight on all marketings of such packaged fluid milk products during the month.

Note: Price formulas are available at www.ams.usda.gov/dairy/price_formula.htm.

(Class I price by location on reverse side)

Released: March 18, 2005

Erik F. Rasmussen
Market Administrator

**Sample Federal Milk Order
Announcement of Class I Price and Advanced Pricing Factors
(contd.)**

**April 2005
Class I Price Information for the Northeast Order**

			Prices		
			Skim	Butterfat	Class I#
			dollars		
			per cwt.	per pound	per cwt.
Class I Mover Factor:			8.35	1.7359	14.13
Selected locations	Differential*	Adjustment			
Boston, MA	3.25	0.00	11.60	1.7684	17.38
Newport News/Portsmouth, VA	3.20	(0.05)	11.55	1.7679	17.33
New York, NY	3.15	(0.10)	11.50	1.7674	17.28
Long Valley, NJ	3.10	(0.15)	11.45	1.7669	17.23
Philadelphia, PA	3.05	(0.20)	11.40	1.7664	17.18
Agawam, MA/Baltimore, MD	3.00	(0.25)	11.35	1.7659	17.13
Frederick, MD/New Holland, PA	2.90	(0.35)	11.25	1.7649	17.03
Mt. Holly Springs, PA	2.80	(0.45)	11.15	1.7639	16.93
Albany/Binghamton, NY	2.70	(0.55)	11.05	1.7629	16.83
Middlebury, VT	2.60	(0.65)	10.95	1.7619	16.73
Syracuse, NY	2.50	(0.75)	10.85	1.7609	16.63
St. Albans/Swanton, VT	2.40	(0.85)	10.75	1.7599	16.53
Watertown/Rochester, NY	2.30	(0.95)	10.65	1.7589	16.43
Buffalo, NY	2.20	(1.05)	10.55	1.7579	16.33
Jamestown, NY	2.10	(1.15)	10.45	1.7569	16.23

* Differentials listed apply to states included in the Northeast marketing area. Outside of this area, differentials may be above or below this range. Cities listed are for reference purposes only. Differentials apply on a county basis.

Price at 3.5% butterfat. Does not include the 20 cent per hundredweight processor assessment, an obligation under the Fluid Milk Promotion Order (7CFR§1160.101 et seq.).

Payment Start Month⁶⁴

Selecting a Payment Start Month

Beginning with the 2003 fiscal year, dairy producers who do not want their payments to begin with the first month of the fiscal year must select the month they want to start receiving payments. Producers will be eligible for the payment rate in the month they select, plus payment rates for the consecutive months that follow. The reason for selecting a different starting month is to maximize the total payments received on the quantity cap of 2.4 million pounds (i.e., if the payment rate for the first three months of the year is anticipated to be \$0.00 or much lower than it will be later in the year, a producer would most likely select the fourth month to begin receiving payments, in an attempt to maximize the payout for his output). All producers involved in a single dairy operation must agree to the starting month. The dairy operation assumes the risk of not reaching the maximum payment quantity based on the month selected by its producers. Payments will not be issued for past months for the sole purpose of reaching the maximum payment quantity.

The Boston Class I fluid milk price is announced to the public the Friday on or before the 23rd of each month. Because of this, producers must make their payment start-month selection on or before the 15th of the month before the month for which payment is sought. For example, if a dairy selects December 2002 as their payment start month, they must make their selection by November 15, 2002.

Producers in a dairy operation who choose not to select a starting month at the time they sign up must inform their local FSA office that they will make a start month selection at a later time. Producers who do not select a start month or make this notification will receive their payments beginning with the first month of the fiscal year.

Producers in a dairy operation cannot select a month for payment if any of the following occurs:

- the month has already begun;
- the month has already passed; or
- the dairy operation produced no milk in that month.

Changing a Payment Start Month

Operators can change a previously selected start month either:

- on or before the 15th of the month before the month selected; or
- at the start of the next fiscal year.

If the selected starting month is never changed, the starting month will remain the same each year for the duration of the MILC contract.

⁶⁴ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>

Modifications and Reconstitutions⁶⁵

Dairy operators must immediately notify FSA of any changes that may affect an operation's MILC contract. Changes include, but are not limited to, changes to the starting month to receive payment for the next fiscal year, death of a producer on the contract, new member joining the operation, member exiting the operation, transfer of shares by sale or other action, or farm reconstitutions. If a reconstitution occurs during the contract period, changes to the MILC contract will take effect the first day of the fiscal year following the month the local FSA office received notification of the changes. However, changes resulting in the reduction of shareholders or producers will take effect immediately upon notification to FSA.

Dairy operators cannot reorganize the structure of a dairy operation for the sole purpose of receiving multiple payments.

MILC Agents⁶⁶

MILC benefits may be disbursed by a dairy marketing cooperative that serves special groups or communities, such as an Amish or Mennonite community. Such producers may authorize an agent of the cooperative or milk handler affiliated with a dairy marketing cooperative to obtain and disburse MILC benefits to the operation. Qualified agents must be approved by FSA.

The dairy operation must grant MILC agents power of attorney authority to act on the operation's behalf. The operator must complete Form FSA-211, "Power of Attorney," and submit the form to the FSA office where the dairy operation is located. The form is available online at: <http://forms.sc.egov.usda.gov/eforms/mainervlet> or from FSA offices.

For More Information⁶⁷

More information on the MILC program is available from local FSA offices or on FSA's website at: <http://www.fsa.usda.gov/dafp/psd/MILC.htm>.

⁶⁵ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm> and Federal Register Vol. 67, No. 202, §1430.212

⁶⁶ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>

⁶⁷ <http://www.fsa.usda.gov/pas/publications/facts/html/milc02.htm>

Feed Grains Market Loss Assistance Program

Summary of 2002-2007 Program



Most information was obtained from various document links at <http://www.fsa.usda.gov/dafp/psd/default.htm> as of March/April 2005. Hard copies of documents as of that timeframe are maintained in the project file.

Overview⁶⁸

The Farm Security and Rural Investment Act of 2002 (2002 Farm Act) provides for direct and counter-cyclical payments, nonrecourse marketing assistance loans, and loan deficiency payments for the 2002-2007 crops to help ensure a strong and viable U.S. agriculture sector. Regulations governing the administration of the direct and counter-cyclical program and the marketing assistance and loan deficiency payments for feed grains are provided in 7 CFR Part 1412 and 1421, respectively.

Direct and counter-cyclical payments reduce financial risks and help producers meet their cash flow needs. Marketing assistance loans provide producers interim financing at harvest time to meet cash flow needs without having to sell their commodities when market prices are typically at harvest-time lows. Allowing producers to store production at harvest facilitates more orderly marketing of commodities throughout the year.

Commodities eligible for direct and counter-cyclical payments and nonrecourse marketing assistance loans for the 2002-2007 crops are wheat, corn, grain sorghum, barley, oats, soybeans, other oilseeds (including sunflowers, canola, safflower, flaxseed, rapeseed, mustard seed, crambe and sesame), rice, upland cotton, and peanuts. Other commodities eligible for nonrecourse marketing assistance loans are Extra Long Staple (ELS) cotton, honey, wool, mohair, dry peas, lentils, and small chickpeas. For ELS cotton, marketing assistance loans must be repaid at the loan rate plus interest and loan deficiency payment provisions do not apply.

The following grains are considered “feed grains”:

- Barley
- Corn
- Grain sorghum
- Oats

Direct payments under the 2002 Farm Act are similar to production flexibility contract (PFC) payments under the Federal Agriculture Improvement and Reform Act of 1996 (1996 Act). Counter-cyclical payment rates depend on market prices and increase as market prices decline below specified levels. Counter-cyclical payments replace ad hoc market loss assistance payments, which supplemented PFC payments under the 1996 Act. Marketing assistance loans and loan deficiency payment provisions of previous legislation are continued under the 2002 Farm Act.

While FSA makes payments for numerous crops, the largest payments appear to be for feed grains (barley, corn, grain sorghum, and oats). According to the fiscal year 2006 budget, total estimated feed grain payments for 2005 are nearly \$8 billion.⁶⁹ Therefore, feed grains were selected as the focus of this paper.

⁶⁸ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

⁶⁹ Budget of the United States Government, Fiscal Year 2006—Appendix, p. 111

Direct and Counter-Cyclical Payments (DCP)

The Direct and Counter-Cyclical Payment (DCP) Program provides payments to eligible producers on farms enrolled for the 2002 through 2007 crop years. There are two types of DCP program payments – direct payments and counter-cyclical payments. Both are computed using the base acres and payment yields established for the farm. DCP was authorized by the Farm Security and Rural Investment Act of 2002 (2002 Farm Act) and is administered by the U.S. Department of Agriculture's Farm Service Agency (FSA).

Direct Payments⁷⁰

Direct payments are annual payments to producers that are engaged in the production of feed grains and other eligible commodities. Direct payments are computed using the base acres and payment yields established for the farm and do not depend on the effective commodity price or current production. The commodity payment amount is calculated as follows:

$$\text{Payment Amount} = (\text{specified rate} \times \text{payment acres} \times \text{payment yield})$$

At the option of the producer, the producer can choose to receive advance payments (up to 50%) during the producer's selected month. The month selected may be any month during the period beginning on December 1 of the calendar year before the calendar year in which the crop of the covered commodity is harvested through the month within which the direct payment would otherwise be made.⁷¹

Direct payments are similar to production flexibility contract (PFC) payments producers received for wheat, feed grains, rice, and upland cotton under the 1996 Act. For each commodity, the direct payment equals the direct payment rate *times* 85 percent of the farm's base acreage *times* the farm's direct payment yield. The direct payment rates for each feed grain are as follows:

Direct Payment Rates

Barley	\$0.24 per bushel
Corn	\$0.28 per bushel
Grain sorghum	\$0.35 per bushel
Oats	\$0.024 per bushel

Timing of Direct Payments

Direct payments for the 2002 crop were made as soon as a farm was enrolled in the direct and counter-cyclical payment program. For the 2003-2007 crops, direct payments are made after October 1 of the year the crop is harvested. Producers may request up to 50 percent of the direct payment in advance, but no earlier than December 1 of the year before the crop is harvested.

⁷⁰ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

⁷¹ Budget of the United States Government, Fiscal Year 2006—Appendix, p. 111.

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The following table shows the 2005 direct payment cycles.

2005 Direct Payment Cycle		
Payment	Barley and Oats	Corn and Grain Sorghum
Advance Direct	December 2004	
Final Direct	October 2005	

Direct Payment Rate Calculation Example⁷²

For each commodity, the direct payment for each crop year equals 85 percent of the farm's base acreage times the farm's direct payment yield times the direct payment rate. The following is an example for corn:

Base acres planted to corn	100 acres
	<u>x 85%</u>
Payment acres	85 acres
Direct payment yield	x 110 bushels
Direct payment rate	<u>x \$0.28 per bushel</u>
Direct payment	\$2,618.00

Direct payments are not based on producers' current production choices, but instead are tied to acreage bases and yields. Because direct payments provide no incentive to increase production of any certain crop, the payments support farm income without distorting producers' current production decisions.

For the 2002-crop year only, producers' final direct payments were reduced by the 2002 PFC payments they had already received.

Counter-Cyclical Payments⁷³

The 2002 Farm Bill added counter-cyclical payments, which provide support counter to the cycle of market prices as part of a "safety net" in the event of low crop prices. Counter-cyclical payments for a commodity are only issued if the effective price for a commodity is below the target price for the commodity. Counter-cyclical payments are computed using the base acres and payment yields established for the farm.

⁷² <http://www.fsa.usda.gov/pas/publications/facts/html/dcp03.htm>

⁷³ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

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Countercyclical payments will be made for the crop as soon as practicable after the end of the 12-month marketing year for the eligible commodity.⁷⁴ If, before the end of the 12-month marketing year, it is determined that counter-cyclical payments will be required for the eligible commodity, producers will be provided the option to receive partial payment of the projected counter-cyclical payment.⁷⁵

Target prices were set in the 2002 Farm Act at the levels shown in the table below.

Target Prices for Feed Grains, 2002-2007 Crops (per bushel) ⁷⁶		
Item	2002 and 2003	2004 through 2007
Target Prices		
Barley	\$2.21	\$2.24
Corn	\$2.60	\$2.63
Grain sorghum	\$2.54	\$2.57
Oats	\$1.40	\$1.44

For each commodity, the counter-cyclical payment equals the counter-cyclical payment rate (CCPR) *times* 85 percent of the farm's base acreage *times* the farm's counter-cyclical payment yield. Counter-cyclical payments are made when a commodity's effective price (EP) is below its target price (TP). The effective price equals the direct payment rate (DPR) *plus* the higher of the:

1. National average farm price (NAFP); or
2. National average loan rate (NALR).

Timing of Counter-Cyclical Payments

For crop years 2002-2006, the counter-cyclical payment cycle consists of two partial payments, if authorized, and a final payment.

- A first partial payment, based on up to 35 percent of the projected payment rate, is made after October 1 of the year the crop is harvested.
- A second partial payment, up to 70 percent of the projected payment rate, is made after February 1 of next calendar year, less any first partial payments already received.
- A final payment is made after the end of the marketing year.

For crop year 2007, the counter-cyclical payment cycle consists of a partial payment, if authorized, and a final payment.

- A first partial payment, up to 40 percent of the projected payment rate, is made after the first six months of the marketing year.
- A final payment is made after the end of the marketing year.

⁷⁴ Per feed grain program fact sheet at <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>, the marketing year for each feed grain is as follows:

- September 1–August 31: Corn, Grain sorghum;
- June 1–May 31: Barley, Oats.

⁷⁵ Budget of the United States Government, Fiscal Year 2006—Appendix, p. 111.

⁷⁶ Federal Register Vol. 67, No. 203, §1412.503 and Federal Register Vol. 67, No. 198, §1421

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If 2002-2007 partial payments exceed the final calculated payment based on the final national average farm price for the marketing year, producers are required to refund the balance.

The following table shows the 2005 counter-cyclical payment cycles.

2005 Counter-Cyclical Payment Cycle		
Payment	Barley and Oats	Corn and Grain Sorghum
1 st Counter-cyclical	October 2004	
2 nd Counter-cyclical	February 2005	
Final Counter-cyclical	July 2005	October 2005

Producers must refund to FSA counter-cyclical payments that exceed the actual counter-cyclical payment for each respective crop. This situation may occur when actual market prices exceed the projected market prices used in determining the partial counter-cyclical payment rates.⁷⁷

Counter-Cyclical Payment Rate Calculation Example⁷⁸

The counter-cyclical payment rate is the amount by which the target price of each commodity exceeds its effective price. The effective price for each commodity equals the direct payment rate plus the higher of the national average market price received by producers during the marketing year or the national loan rate for the commodity.

The 2002 corn national average loan rate is \$1.98 per bushel. Assuming the 2002/03 corn national average farm price is \$2.25 per bushel, the counter-cyclical payment rate per bushel is calculated as follows:

$$TP - [DPR + (\text{higher of NAFF or NALR})] = \$2.60 - [\$0.28 + (\text{higher of } \$2.25 \text{ or } \$1.98)] =$$

$$TP - [DPR + NAFF] = \$2.60 - [\$0.28 + \$2.25] =$$

$$TP - EP = \$2.60 - \$2.53 =$$

$$= CCPR = \$0.07$$

where,

CCPR = Counter-Cyclical Payment Rate

DPR = Direct Payment Rate

EP = Effective Price

NAFF = National Average Farm Price

NALR = National Average Loan Rate

TP = Target Price

⁷⁷ <http://www.fsa.usda.gov/pas/publications/facts/html/dcp03.htm>

⁷⁸ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

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Base acres planted to corn	100 acres
	<u>x 85%</u>
Payment acres	85 acres
Counter-cyclical payment yield	x 110 bushels
Counter-cyclical payment rate	<u>x \$0.07 per bushel</u>
Counter-cyclical payment	\$654.50

Maximum Counter-Cyclical Payment Rate

Maximum Counter-Cyclical Payment Rate (per bushel)		
Commodity	Crop Years 2002-2003	Crop Years 2004-2007
Barley	\$.09	\$.15
Corn	\$.34	\$.40
Grain Sorghum	\$.21	\$.27
Oats	\$.026	\$.086

Eligibility Requirements⁷⁹

Producers are eligible for direct and counter-cyclical payments on farms with eligible acreage bases. To be eligible for payments under the direct and counter-cyclical program (DCP), owners, operators, landlords, tenants, or sharecroppers must:

- sign a DCP agreement (Form CCC-509, “Direct And Counter-Cyclical Program Contract”) with the Farm Service Agency (FSA);
- share in the risk of producing a crop on base acres on a farm enrolled in DCP, and be entitled to share in the crop available for marketing from the base acres or would have shared had a crop been produced;
- annually report the use of the farm’s cropland acreage;
- comply with conservation and wetland protection requirements on all of their land;
- comply with planting flexibility requirements;
- use the base acres for agricultural or related activities; and
- protect all base acres from erosion, including providing sufficient cover as determined necessary by the county FSA committee, and control weeds.

Farms that did not have a current production flexibility contract under the 1996 Farm Bill or did not plant covered commodities from 1998-2002 cannot establish a base under the 2002 Farm Bill and are ineligible for direct and counter-cyclical payments.⁸⁰

⁷⁹ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm> and <http://www.fsa.usda.gov/pas/publications/facts/html/dcp03.htm>

⁸⁰ <http://www.fsa.usda.gov/pas/farmbill/printall.asp> FAQ 177 and 174

Sign-up Period⁸¹

The DCP sign-up period for fiscal years 2002 and 2003 was October 1, 2002, to June 2, 2003. Sign-up for fiscal years 2004 through 2007 is from October 1 to June 1 of the applicable fiscal year. The CCC-509 form, "Direct and Counter-Cyclical Program Contract," includes base acres, payment acres, payment yields, producer payment shares, advance direct and counter-cyclical payment selections, and signatures of the producer and county office representative.

The CCC-509 must be submitted by June 1 (June 2 for 2002 and 2003) of the fiscal year. All owners and operators who will share in the DCP payments on the farm must sign the CCC-509. Forms with signatures that are obtained after June 1, but before September 30, will be accepted, but the farm will be assessed a late-file sign-up fee of \$100.

Farm producers must apply for DCP on an annual basis and can opt out of participating in DCP for any year if they so choose.

The following documents are required and applicable determinations must be made before the county committee can approve a producer's share on the CCC-509 for payment:

- a farm operating plan (CCC-502 and related forms);
- an average adjusted gross income certification (CCC-526);
- a certification of compliance with highly erodible land and wetland conservation provisions (AD-1026).

A certification of the acreage of all cropland on the farm (FSA-578) is needed before final payments can be issued.

National Average Farm Prices⁸²

The national average farm price is the market price producers receive during the marketing year as determined by the National Agricultural Statistics Service (NASS). Average market prices producers receive are published near the last business day of each month in *Agricultural Prices*, which can be found by visiting the NASS reports calendar Web site at www.usda.gov/nass/pubs/rptscal.htm.

Note that the feed barley national average farm price is used for determining the barley counter-cyclical payment rate.

Monthly updates of U.S. Department of Agriculture's projected national average farm prices can be found in the *World Agricultural Supply and Demand Estimates* reports by visiting the World Agricultural Outlook Board's Web site at: www.usda.gov/oce/waob/wasde/wasde.htm.

⁸¹ <http://www.fsa.usda.gov/pas/publications/facts/html/dcp03.htm>

⁸² <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

Acresage Base and Program Yield Election⁸³

Landowners had a one-time opportunity in 2003 to either:

1. Use their farm's 2002 PFC acresage and add acresage bases for oilseeds and peanuts that reflect average 1998-2001 plantings; or
2. Update their farm's acresage bases to reflect average 1998-2001 plantings for all commodities eligible for direct and counter-cyclical payments.

If they chose to update their farm's acresage bases, they could also update their counter-cyclical payment yields using one of the following two methods:

1. 93.5 percent of the 1998-2001 average yield; or
2. The direct program payment yield (the PFC payment yield in effect under the 1996 Act) *plus* 70 percent of the difference between the 1998-2001 average and the direct program payment yield.

For wheat, feed grains, rice, and upland cotton, direct payment yields are the same as the payment yields that were used for making PFC payments. For soybeans and other oilseeds, direct payment yields are based on 1998-2001 production histories, adjusted to reflect 1981-85 yields.

If no election was made before the 2002-crop election period ended, acresage bases for the farm were established using the farm's 2002 PFC acresage and adding acresage bases for oilseeds.

For these farms, direct and counter-cyclical payment yields for wheat, feed grains, rice, and upland cotton are the same as those yields used for making PFC payments. For soybeans and other oilseeds, yields were assigned based on the county acresage where the farm is located, adjusted to reflect 1981-85 yields.

Planting Flexibility⁸⁴

The 2002 Farm Act extends the 1996 Act's planting flexibility. Generally a producer may plant any commodity or crop on base acres without penalty. Some restrictions, however, apply depending on a producer's or farm's planting history.

The Farm Act adds wild rice to the fruit and vegetable crops subject to planting restrictions, but slightly eases the restrictions compared with those under the 1996 Act. To be eligible for loan benefits and payments under the 1996 Act, producers signed 7-year contracts and fruit and vegetable restrictions applied to the entire contract period. Under the Farm Act, producers may annually opt out of eligibility for direct and counter-cyclical payments and plant fruits, vegetables and wild rice, yet remain eligible for marketing assistance loans for all loan-eligible commodities.

A producer cannot receive direct or counter-cyclical payments on a farm where plantings include fruits, vegetables (other than lentils, mung beans, and dry peas) and wild rice (FAV/WR) on base acres unless the commodity is destroyed before harvest or meets the following statutory exceptions. Plantings of FAV/WRs are not limited:

⁸³ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

⁸⁴ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

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1. In any region with a history of double cropping commodities eligible for direct and counter-cyclical payments with FAV/WRs;
2. On a farm with a history of planting FAV/WRs (using either the 1991-95 or 1996-01 period) except that direct and counter-cyclical payments will be reduced by an acre for each acre planted to an FAV/WR; and
3. By a producer with an established history of planting a specific FAV/WR, except that the acreage may not exceed the average annual plantings in the 1991-1995 or the 1998-2001 crop years (excluding any crop year with no plantings) and that direct and counter-cyclical payments shall be reduced by an acre for each acre planted to an FAV/WR.

Payment Limitations⁸⁵

The Farm Act also establishes limits on payments a "person" may receive from farm programs. The definition of "person" includes individual farmers, but also encompasses limited partnerships, corporations, and other types of organizations. The 3-entity rule, carried over from previous legislation, limits to three the number of entities through which a "person" may receive payments.

The per "person" payment limitations apply for each crop year for the following:

Direct Payments

- \$40,000 total for wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, and other oilseeds; and
- \$40,000 for peanuts.

Counter-Cyclical Payments

- \$65,000 total for wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, and other oilseeds; and
- \$65,000 for peanuts.

In addition, starting with the 2003 crop, individuals and entities whose previous 3-year average adjusted gross income (AGI) exceeds \$2.5 million are ineligible for many program benefits, including direct and counter-cyclical payments, unless they can establish that at least 75 percent of their AGI is derived from agriculture.

⁸⁵ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

Nonrecourse Marketing Assistance Loans and Loan Deficiency Payments

The Farm Security and Rural Investment Act of 2002 (Sections 1201-1209), continues nonrecourse marketing assistance loans and loan deficiency payment (LDP) provisions of previous legislation. The 2002 Farm Act provides for nonrecourse marketing assistance loans and LDPs for the 2002-2007 feed grain (barley, corn, grain sorghum, and oats) crops.

Marketing assistance loans provide producers with interim financing at harvest time to meet cash flow needs without having to sell their commodities when market prices are typically at harvest-time lows. A producer who is eligible to obtain a loan, but who agrees to forgo the loan, may obtain an LDP.

The feed grains nonrecourse marketing loans and loan deficiency payments are not discussed in the current issue paper. They are presented for informational purposes only in order to present the full scope of the feed grains program.

Nonrecourse Marketing Assistance Loans⁸⁶

The Farm Act provides for 9-month barley, corn, grain sorghum, and oats nonrecourse marketing assistance loans. Marketing assistance loans allow a producer growing eligible crops to store production and use loan proceeds to meet cash flow needs without selling the crop. These loans are nonrecourse because a producer pledges the crop as collateral and has the option of delivering the pledged commodity to the Commodity Credit Corporation (CCC) as full settlement of the loan at maturity.

Actual loan rates are based on each commodity's national average loan rate, and they:

- Vary by county;
- Are based on the county where the commodity is stored; and
- May be adjusted by CCC with premiums and discounts to reflect quality factors.

A producer is also eligible for a loan deficiency payment (LDP) in lieu of obtaining a loan.

Loan Repayment Rates⁸⁷

The loan repayment rate is the *lower* of the:

1. Applicable county loan rate plus accrued interest and other charges (per unit); or
2. CCC determined local market price for the respective commodity, often referred to as the posted county price (PCP).

Loan repayment rates are established and available at each county FSA office. PCPs are based upon the previous day's market prices for each feed grain at appropriate U.S. terminal markets, adjusted to reflect quality and location.

⁸⁶ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

⁸⁷ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

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Marketing Loan Gains⁸⁸

A producer realizes a marketing loan gain if the loan is repaid at less than the loan principal. The marketing loan gain rate equals the amount by which the applicable loan rate exceeds the loan repayment rate.

Loan Settlements⁸⁹

Loans mature on the last day of the ninth calendar month following the month in which the loan is approved. A producer may repay a marketing assistance loan at any time. A producer may settle an outstanding nonrecourse loan:

- During the 9-month loan period by repaying the loan; or
- Upon maturity by forfeiting the commodity to CCC.

Loan Deficiency Payments (LDPs)⁹⁰

A producer who is eligible to obtain a loan, but who agrees to forgo the loan, may obtain a Loan Deficiency Payment (LDP). The LDP rate equals the amount by which the applicable county loan rate where the commodity is stored exceeds the loan repayment rate for the respective commodity. The LDP equals the LDP rate times the quantity of commodity for which the LDP is requested.

The following table provides an example of how corn marketing loan gains and LDPs are calculated.

Corn Marketing Loan Gain/Loan Deficiency Payment Examples			
	Loan Repayment Rate Scenario		
	Scenario 1	Scenario 2	Scenario 3
	dollars per bushel		
Loan rate	1.98	1.98	1.98
Loan rate plus interest	2.05	2.05	2.05
Posted County Price (PCP)	2.50	2.00	1.75
Lower of loan rate plus interest or PCP	2.05	2.00	1.75
Marketing Loan Gain or LDP rate	0.00	0.00	0.23

Final Loan/LDP Availability Dates⁹¹

The final loan/LDP availability date is March 31 for barley and oats and May 31 for corn and grain sorghum of the calendar year after the calendar year the grain is harvested. For example, for crop year 2005:

Barley and Oats	March 31, 2006
Corn and Grain Sorghum	May 31, 2006

A producer may obtain a loan or receive an LDP on all or part of their eligible production at any time during the loan availability period.

⁸⁸ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

⁸⁹ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

⁹⁰ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

⁹¹ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

Eligibility Requirements⁹²

To be eligible for marketing assistance loans and LDPs, producers must:

1. Comply with conservation and wetland protection requirements;
2. Report how they use all their cropland acreage on the farm;
3. Have *beneficial interest* in the commodity on the date the loan or LDP is requested and, in the case of a loan, retain beneficial interest while the loan is outstanding; and
4. Ensure that the grain meets CCC minimum grade and quality standards.

Direct and counter-cyclical payment agreements are not required for marketing assistance loan eligibility.

A producer retains beneficial interest in the commodity if all of the following remain with the producer:

- **Control of the commodity** - The producer retains the ability to make all decisions affecting the commodity, including movement, sale, and the request for a loan or LDP;
- **Risk of loss in the commodity** - The producer is responsible for loss or damage to the commodity. If the commodity is insured, any indemnity must be payable to the producer; and,
- **Title to the commodity** - The producer has not sold or has not delivered the commodity or warehouse receipt to the buyer. Title may be considered to be transferred before the producer receives payment for the commodity. For example, title is considered transferred if a producer executes an option to purchase without a provision in the agreement that states that title, risk, and beneficial interest remain with the producer until the buyer exercises this option to purchase and the option to purchase expires at the earlier of:
 - a. The maturity of any CCC loan secured by such commodity,
 - b. The date CCC claims title to such commodity, or
 - c. Another date provided in the option.

Once beneficial interest in the commodity is lost, the commodity loses eligibility for a loan or LDP and remains ineligible even if the producer later regains beneficial interest. For further information see the FSA fact sheet on *Beneficial Interest Requirements For Loans and LDPs*, contact a local FSA county office, or visit the FSA Web site at www.fsa.usda.gov.

⁹² <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

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Loan Rates⁹³

Loan rates are set in the Farm Act at the levels shown in the following table.

Loan Rates for Feed Grains, 2002-2007 Crops (per bushel) ⁹⁴		
Item	2002 and 2003	2004 through 2007
Loan Rates		
Barley	\$1.88	\$1.85
Corn	\$1.98	\$1.95
Grain sorghum	\$1.98	\$1.95
Oats	\$1.35	\$1.33

Commodity Certificates⁹⁵

Commodity certificates are available to producers to use in acquiring 2002 through 2007 crop collateral pledged to CCC for a commodity loan. Producers with outstanding nonrecourse marketing assistance loans may purchase commodity certificates and exchange them for loan collateral at USDA Service Centers. The exchange rate will be the PCP on the date the commodity certificate is purchased. Commodity certificate exchanges will not be available when the exchange rate exceeds the applicable loan rate. Realized gains from the certificate exchange, also called certificate exchange gains, equal the amount by which the loan rate exceeds the PCP. For further information, see the FSA fact sheet *Commodity Certificates*, contact a local FSA office, or visit the FSA Web site at: www.fsa.usda.gov.

Production Evidence⁹⁶

A producer who repays a loan at less than the loan rate plus accrued interest and other charges or receives an LDP must provide production evidence acceptable to CCC, such as evidence of sales, warehouse receipts, or load summary or assembly sheets.

Adjusted Gross Income Limitations⁹⁷

Starting with the 2003 crop, individuals and entities whose previous 3-year average adjusted gross income (AGI) exceeds \$2.5 million are ineligible for many program benefits unless they can establish that at least 75 percent of their AGI is derived from agriculture. Program benefits for which individuals or entities exceeding the AGI Limit will be ineligible include:

- Direct payments;
- Counter-cyclical payments;
- Loan deficiency payments;
- Marketing loan gains;

⁹³ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

⁹⁴ Federal Register Vol. 67, No. 203, §1412.503 and Federal Register Vol. 67, No. 198, §1421

⁹⁵ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

⁹⁶ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

⁹⁷ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

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- Agricultural Management Assistance Program;
- Conservation Security Program;
- Conservation Reserve Program;
- Environmental Quality Incentives Program;
- Farmland Protection Program;
- Grassland Reserve Program;
- Ground and Surface Water Conservation Program;
- Wetland Reserve Program.

Payment Limitations⁹⁸

The Farm Act also establishes limits on payments a "person" may receive from farm programs. The definition of "person" includes individual farmers, but also encompasses limited partnerships, corporations, and other types of organizations. The 3-entity rule, carried over from previous legislation, limits to three the number of entities through which a "person" may receive payments.

The per "person" payment limitations for marketing loan gains and loan deficiency payments apply for each crop year for the following:

- \$75,000 total for wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, other oilseeds, dry peas, lentils and small chickpeas; and
- \$75,000 total for peanuts, wool, mohair, and honey.

The sum of marketing loan gains and LDPs for the commodities listed above is subject to a \$75,000-per-person payment limitation for each crop year. This payment limitation is separate from the \$40,000-per-person limitation for direct payments and \$65,000-per-person limitation for counter-cyclical payments. For more information on payment limitations see the FSA fact sheet *Payment Eligibility and Limitations*, contact a local FSA office, or visit the FSA Web site at www.fsa.usda.gov.

⁹⁸ <http://www.fsa.usda.gov/pas/publications/facts/html/feedgrains03.htm>

Comparison of Selected Characteristics of MILC and DCP				
<u>Characteristic</u>	<u>MILC</u>		<u>DCP</u>	
	<u>Transition Period Payments</u>	<u>Monthly Contract Payments</u>	<u>Direct Payments</u>	<u>Counter-Cyclical Payments</u>
Is there a contingent event upon which payment is based?	No Transition period payments are based on past events at the time of signup; monthly contract payments are made based upon whether or not the Boston Class I milk price falls below \$16.94 per cwt in the future.	Yes	No Direct payments made regardless of what the market price is. Counter-cyclical payments are only made when the effective price for the covered commodities falls below the target price in the future.	Yes
Are payments based on actual or projected amounts?	Actual Transition period and monthly contract payments are made based upon known production and milk prices.	Actual	Actual Direct and counter-cyclical payments are both calculated based upon base acres and payment yields established for the farm. However, the first two partial counter-cyclical payments are also based on projected market prices. The final counter-cyclical payment is based on actuals.	Projected/Actual
Do program payments affect current production choices?	Yes/No Some argue that since the payments are linked to production and the Boston Class I milk price is announced before the month in which the milk is produced, this program leads to an over-production of milk in months that producers know price support payments will be made. This over-production could in turn result in a surplus of milk that causes market prices to fall even lower. There could also be an affect on production during the transition period since producers can sign up any time until September 30, 2005. However, there would not be an effect on transition period production from December 1, 2001 through July 31, 2002, since those months were paid retroactive to the beginning of the program.	Yes	No Since payments are not linked to current production, neither direct payments nor counter-cyclical payments affect current production choices.	No
Do producers need to actually produce anything?	Yes Payments are directly linked to production – no production, no payments.	Yes	No Since payments are based on historical base acres and payment yields established for the farm and not current production, producers do not need to produce anything in the current year to receive payment.	No
Are payment rates set in current law?	No Payments are based on the current Boston Class I milk price for any given month. The payment formula is set in current law.	No	Yes The direct payment rates are established in current law. The counter-cyclical payment rates depend on the current national average farm price for the marketing year. The payment formula is set in current law.	No

Comparison of Selected Characteristics of MILC and DCP				
Characteristic	MILC		DCP	
	Transition Period Payments	Monthly Contract Payments	Direct Payments	Counter-Cyclical Payments
Is there a limit on producer adjusted gross income?	No There is no adjusted gross income limit placed on producers under the MILC program.	No	Yes Starting with the 2003 crop, individuals and entities whose previous 3-year average adjusted gross income (AGI) exceeds \$2.5 million are ineligible for many DCP program benefits unless they can establish that at least 75 percent of their AGI is derived from agriculture.	Yes
Is there an annual cap on payments?	Yes Payments for each year in the transition period and each annual contract period cannot exceed 2.4 million pounds of production.	Yes	Yes Direct and counter-cyclical payments are limited to \$40 thousand and \$65 thousand, respectively, per individual per year.	Yes
Do producers have to meet specific program requirements?	Yes To be eligible to receive payments under the MILC program, a dairy operation must: <ul style="list-style-type: none">• have produced milk in the United States and commercially marketed the milk anytime during the period of December 1, 2001, through September 30, 2005;• enter into a MILC (Form CCC-580, "Milk Income Loss Contract") during the contract application period;• agree to all terms and conditions in the MILC and comply with instructions issued by the Commodity Credit Corporation;• provide proof of monthly milk production commercially marketed by all persons in the dairy operation during the contract period to determine the total pounds of milk that will be converted to hundredweight (cwt.) used for payment;• submit evidence of production in a timely manner;• Complete Form AD-1026, "Highly Erodible Land Conservation and Wetland Conservation Certification," used to certify understanding of the conservation compliance requirements under USDA programs; and,• be actively engaged in the business of producing and marketing agricultural products at the time of signing the MILC.	Yes	Yes To be eligible for payments under the DCP program, owners, operators, landlords, tenants, or sharecroppers must: <ul style="list-style-type: none">• sign a DCP agreement (Form CCC-509, "Direct And Counter-Cyclical Program Contract") with the Farm Service Agency (FSA);• share in the risk of producing a crop on base acres on a farm enrolled in DCP, and be entitled to share in the crop available for marketing from the base acres or would have shared had a crop been produced;• annually report the use of the farm's cropland acreage;• comply with conservation and wetland protection requirements on all of their land;• comply with planting flexibility requirements;• use the base acres for agricultural or related activities; and• protect all base acres from erosion, including providing sufficient cover as determined necessary by the county FSA committee, and control weeds.	Yes

Appendix 5 – Comparison of MILC to DCP

Staff Note: Although there are some differences between the MILC program and the DCP program selected above, they are very similar. In line with previous staff recommendations and Board deliberations on this and other projects, staff has recommended the point of submission of the contract and evidence of supporting documentation as the obligating event for both programs. Staff feels this is the most appropriate obligating event for both programs because it is the point at which the producers take the first step to accept the terms of the program, establish that they meet the conditions of the program, and begin performing under the terms of the program. Staff does not consider the FSA approval of the contracts to be required in order to create an obligating event because, in its discussion of the SSI program at the March 2005 Board meeting, several Board members were uncomfortable with inserting the government determination or approval as a required step in the process. It was felt that, if the government laid out the conditions of the program, and there were individuals out there who met the conditions of the program, the government could have a liability, exclusive of the fact of whether the government had verified that the individuals had, in fact, met the conditions of the program.

While both programs contain aspects of contingencies at the point of application (MILC monthly contract payments are contingent upon the Boston Class I milk price falling below \$16.94 per cwt and DCP counter-cyclical payments are contingent upon the effective price of the commodities falling below the target price), staff believes that FSA management would be the most appropriate individuals to determine whether, for any given year, a drop in the milk price or a drop in the effective price of feed grains below the target price is probable and measurable. Staff believes that it would not be appropriate for the Board to decide what is probable or measurable on a case by case basis. The established criteria would be sufficient to guide FSA and its auditors in determining what is probable and measurable. The draft liability characteristics presented by staff on the Elements project purposely exclude an explicit discussion of probability in order to cast a wide net for designation as a liability. It is up to the Board to decide if they prefer the wide net or a narrower one, and tailor the liability definition accordingly. Therefore, staff believes, based on an analysis of both the MILC program and the DCP program, that the point of submission of the contract and documentation of supporting evidence meets both the two characteristics of a present obligation proposed under the Social Insurance Liability Project and the two characteristics of a liability proposed under the Elements project.